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**Vol. I.**

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**TRANSCRIPT OF RECORD.**

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**SUPREME COURT OF THE UNITED STATES.**

**OCTOBER TERM, 1913.**

**No. 571.**

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**THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
APPELLANT,**

**vs.**

**THE UNITED STATES AND THE INTERSTATE COMMERCE  
COMMISSION.**

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**APPEAL FROM THE UNITED STATES COMMERCE COURT.**

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**FILED MAY 24, 1913.**

**(23,717)**





(23,717)

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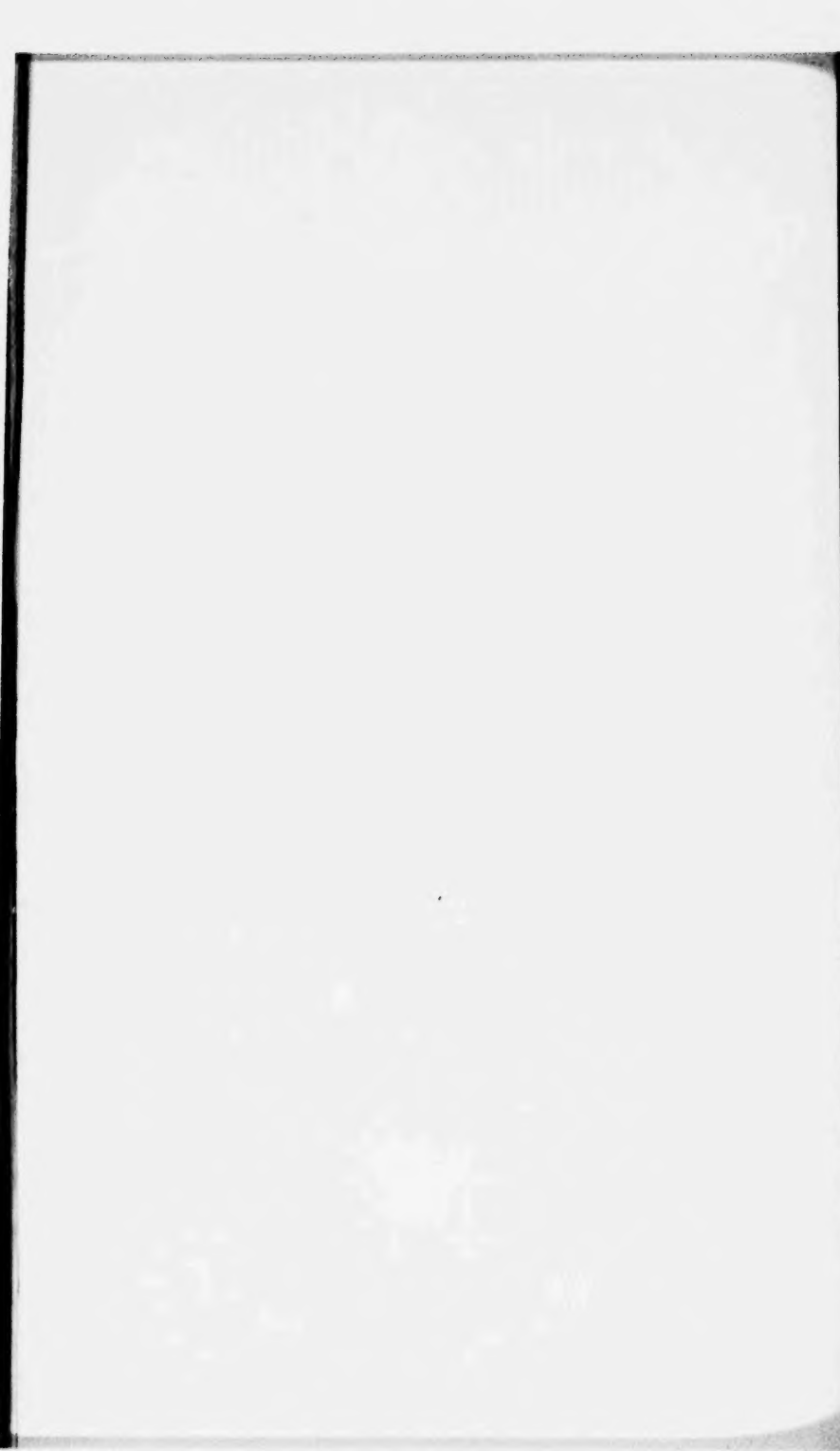
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ment, and especially of its roadway. It was and continues to be in active competition with powerful rivals operating in the same general territory. The character of its road as a trunk line, resulting in a long average haul, and the prevalence of low class traffic necessarily entail a low average freight rate. These conditions rendered it imperative that your Petitioner should so improve its roadway as to admit of the freest possible movement of traffic and to reduce its operating costs to a minimum, in order that any substantial profit might be realized from its operations.

In June, 1906, or thereabouts, Mr. Horace G. Burt, who was formerly President of the Union Pacific Railroad system, and who is generally recognized in the railroad world as a leading railroad expert and civil engineer, was employed by your Petitioner to make an exhaustive examination of the conditions affecting its physical property and to report on the means in his opinion best adapted to its improvement. On or about June 25, 1907, Mr. Burt's report was rendered. The principal recommendation embodied therein was an extensive program of grade reduction to an ultimate line having a maximum grade of  $\frac{1}{2}$  of 1 per cent., in both directions.

3 In order to provide the funds necessary to certain of the improvements recommended by Mr. Burt and contemplated by your Petitioner, its board of directors, on April 28, 1909, at a meeting duly called and held, adopted a resolution providing, among other things, that \$10,000,000 face value of your Petitioner's Refunding and Improvement Mortgage Gold Bonds, secured by a mortgage to be dated July 1, 1909, and bearing interest at the rate of 5 per cent. per annum, should be issued and sold, and that the proceeds of the said issue of \$10,000,000 of bonds should be devoted and applied to certain specified corporate needs of your Petitioner, including additions to and betterments of its property.

On April 29, 1909, a meeting of the stockholders of your Petitioner was called to be held at Kansas City, Missouri, on June 29, 1909. On May 20, 1909, a circular letter was, upon the authority of the board of directors, addressed and mailed to each of the said stockholders, specifying the uses to which your Petitioner intended to apply the proceeds from the sale of the said \$10,000,000 of Refunding and Improvement Bonds, as follows:

- |   |             |
|---|-------------|
| 1. To pay off the Collateral Gold Notes on July 1, 1909.  | \$5,100,000 |
| 2. To reducing grades to one-half of one per cent. on three full operating divisions, aggregating 41 per cent. of the total length of the line..... | 1,250,000   |
| 3. To rearranging four division terminals to permit of better and more economical operation under   |             |
| 4 the sixteen-hour law and to provide more adequate facilities for taking care of the power and traffic.....  | 1,000,000   |
| 4. To ditching, ballasting, new rails, improvements to track and bridges.....   | 1,000,000   |

The balance to be used for the improvement of terminal facilities at Kansas City and Port Arthur; for facilities for securing new business and for other corporate purposes.....	1,275,000
<b>Total .....</b>	<b><u>\$9,625,000</u></b>

Pursuant to the said call, a meeting of the stockholders of your Petitioner was duly held on June 29, 1909, whereat resolutions were duly adopted consenting to and authorizing the issuance and sale of said \$10,000,000 of bonds secured by the aforesaid Refunding and Improvement Mortgage, to be dated July 1, 1909.

Your Petitioner, in pursuance of the aforesaid authority and mandates of its board of directors and its stockholders, thereupon duly executed and delivered its Refunding and Improvement Mortgage, dated July 1, 1909, securing said \$10,000,000 of bonds as aforesaid; and sold and delivered \$10,000,000 face value of its said bonds and realized in part therefrom \$1,250,000 applicable to the said purpose of reducing grades to .5 of 1 per cent. on a considerable portion of its line.

The said mortgage provides in part as follows:

"The Railway Company covenants to use the bonds so delivered to it and the proceeds thereof in calling in and redeeming and cancelling its Five million one hundred thousand (\$5,000,000) Collateral Gold Notes issued April 2, 1903, and for the general improvement of its property."

Said mortgage further provides that if your Petitioner fails duly to observe and perform the aforesaid covenant, the Trustees under the Mortgage may proceed to enforce the security thereof in the manner therein provided, by foreclosure or otherwise.

Third, Your Petitioner proceeded promptly to effect the improvements contemplated and provided for by the resolutions above mentioned, including the reduction of grades, and to apply to the expenditures therefor the funds appropriated for that purpose and realized from the sale of bonds, as above set forth.

In pursuance of the recommendations of Mr. Burt and your Petitioner's engineers, your Petitioner determined to revise its grade to a maximum of .5 of 1 per cent. at six different points or portions of its line which are more fully described in Exhibit "A" hereto annexed and hereby made a part hereof.

Two methods of so reducing the grades at said six points or portions of the line were presented; one by means of lowering or raising the then existing roadway, or both, on the then existing right of way; the other, by the construction of short sections of new road and the abandonment of the sections of road thus replaced.

From the reports and estimates made by Mr. Burt, acting in the capacity of consulting engineer, and by your Petitioner's other engineers, your Petitioner ascertained that the reduction of its grade to

6 .5 of 1 per cent. at said six portions of its line by the method of raising or lowering the then existing roadway, or both, or the then existing right of way, would have required the expenditure of approximately \$1,230,318.99.

Your Petitioner also ascertained from the said reports and estimates of Mr. Burt and its other engineers, that the reduction of its grade to .5 of 1 per cent. at said six portions of its line by the construction of short sections of new road and the abandonment of the sections of road thus replaced, would require the expenditure of approximately \$634,183.74; and that the said expenditure would be reduced by the salvage of material not employed in the construction of said new sections of road to the amount of approximately \$1,784 which would make the net expenditure approximately \$629,399.74.

The saving in capital expenditure resulting from the adoption of changes of line as a means to grade reduction would be approximately \$600,919.25, as is shown by the following tabulated statement:

Cost by changes on original roadbed would be . . . . .	\$1,230,318.99
Cost by changing locations as means to grade reduction . . . . .	\$634,183.74
Less net salvage . . . . .	1,784.00
Net cost . . . . .	629,399.74
Saving resulting from the adoption of changes of line . . . . .	\$600,919.25

7 In other words, your Petitioner found that through the device of reducing the grade by means of new locations substantially the same results could be attained at a great saving, as compared with the cost of revising the grades on the original roadway. In the judgment of your Petitioner and its directors and officers, it was overwhelmingly in the interest of your Petitioner that the reductions in grade should be made by means of the new locations. Furthermore, if made at all it would be necessary that such reductions should be made by that method because the reduction of the grades at the higher cost would not have been justified and could not have been profitably financed by your Petitioner for years to come. For these reasons your Petitioner determined to adopt said six changes of line solely as a means to grade reduction.

Your Petitioner, on or about August 25, 1909, caused contracts to be let for the revision of grades at the six portions of the line above referred to, in accordance with said plans and specifications and as authorized by the directors and stockholders of your Petitioner, as aforesaid. The work at said six points or portions of the line has been substantially completed by means of said new locations, effecting the reduction of the grade to a maximum of .5 of 1 per cent., at an aggregate cost of approximately \$634,183.74.

The said six sections of your Petitioner's line were well located at

the time the road was constructed, and were, at the time of the abandonment thereof, reasonably well adapted to the needs of your Petitioner; and the changes of location were adopted solely as the most economical means of securing a lower grade and thereby of reducing the expenses of operation, to enable your Petitioner to meet the present exigencies of competition, and the better to perform its functions as a common carrier, and for no other reason or purpose whatsoever.

Your Petitioner is informed and believes and so alleges that the said expenditures were judiciously made in the exercise of sound business judgment.

Exhibit "A," above referred to, shows in detail the estimated expenditure by the method of revision on the existing roadway; and the cost by the method adopted, together with the estimated cost of replacing line abandoned, salvage, and value of old material used.

Fourth. At the time said grade revisions were contemplated, projected and made, your Petitioner intended and at all times claimed and now claims the right to enter and carry in its property accounts the amount expended therefor, as aforesaid. Certain alleged orders, classifications and regulations of the Interstate Commerce Commission, hereinafter more fully referred to and set forth, unreasonably and wrongfully prevent your Petitioner from adding to its property accounts the net amount of said expenditure of approximately \$634,183.74 made in reducing the grade to 5 of 1 per cent, on the said six portions of the line, but require that a counterbalance shall be made so that the estimated replacement cost of the abandoned portions of the line (less salvage) shall be charged to the operating expense and Profit and Loss accounts of your Petitioner, thus in effect largely reducing the said sum of \$634,183.74 carried into your Petitioner's property accounts.

After your Petitioner had resolved through its directors and stockholders to revise its said grades, had financed the expenditures incident thereto, and had incurred large expenditures in making surveys and for the defrayment of engineering and other expenses preliminary thereto, the Interstate Commerce Commission, on or about August 15, 1909, issued, published and promulgated its "Classification of Expenditures for Additions and Betterments, as prescribed by the Interstate Commerce Commission for Steam Roads in accordance with Section 20 of the Act to regulate commerce, First Issue, effective on July 1, 1909." The said Classification of Expenditures for Additions and Betterments purported to be issued and promulgated under the authority of an alleged order of the said Commission, claimed to have been entered or adopted on or about June 21, 1909, of which the following is a copy:

"At a General Session of the Interstate Commerce Commission, Held at its Office in Washington, D. C., on the 21st day of June, 1909,

## Present:

Martin A. Knapp,  
Judson C. Clements,  
Charles A. Prouty,  
Francis M. Cockrell,  
Franklin K. Lane,  
Edgar E. Clark,  
James S. Harlan,  
Commissioners.

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

It is ordered, That the Classification of Expenditures for Additions and Betterments for Steam Roads and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form to be hereafter known as First Issue, a copy of which is now before this Commission, be, and the same is hereby approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

It is further ordered, That the said Classification of Expenditure for Additions and Betterments with the text pertaining thereto be and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of their accounts of expenditures for additions and betterments; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts of expenditures for additions and betterments in conformity therewith; and that a copy of said First Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

It is further ordered, That the rules contained in said First Issue of the Classification of Expenditures for Additions and Betterments, are, and by virtue of this order do become, the lawful rules according to which the said expenditures for additions and betterments are defined; and that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of the accounts of expenditures for additions and betterments of any such carrier; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier or for any person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier to keep any account or record or memorandum of any item of expenditure for additions or betterments except in the manner



and form in said First Issue set forth and hereby prescribed, and except as hereinafter authorized.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in said First Issue established as may be required for the purposes of any such carrier or of any receiver or operating trustee of any such carrier; or may make assignment of the amount charged to any such primary account to divisions, to its individual lines, or to States: Provided, however, That a list of such subprimary accounts set up or such assignments made by any such carrier or by any receiver or operating trustee of any such carrier be first filed in the office of the Bureau of Statistics and Accounts of this Commission subject to disapproval by the Commission.

It is further ordered, That in order that the basis of comparison between the fiscal year ending June 30, 1910, and previous years be not destroyed, any such carrier or any receiver or operating trustee of any such carrier may, during the twelve months ending June 30, 1910, keep and maintain, in addition to the accounts of expenditures for additions and betterments hereby prescribed, such portion or portions of its present accounts with respect to items of expenditures for additions and betterments as may be deemed desirable by any such carrier, or by any receiver or operating trustee thereof, for the purposes of such comparison; or, during the same period, may maintain such groupings of the primary accounts hereby prescribed as may be desired for that purpose.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier may, in addition to the accounts of expenditures for additions and betterments hereby prescribed, keep any temporary or experimental accounts the purpose of which is to develop economies in the construction of additions and betterments: Provided, however, That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed; and that any such temporary or experimental accounts shall be open to inspection by the Commission.

It is further ordered, That July 1, 1909, be, and is hereby, fixed as the date on which said First Issue shall become effective."

The Classification of Expenditures for Additions and Betterments for Steam Roads, referred to in the said alleged order, contains, among other things, the following provisions under the head "Introductory Letter":

12 "Third, Accounting Series Circular No. 11 tentatively provided that when any abandonment of property occurred, whether such property was replaced by new and improved property or not, the original cost of the property abandoned should be credited to Additions and Betterments and charged to Operating Expenses. The present classification provides that Operating Expenses should be charged only in case the abandoned property (other than land or equipment) is replaced; and the amount to be charged is now based upon the cost of replacing in kind the abandoned property instead of the original cost as provided in the circular.

When property (other than land or equipment) is abandoned in the course of betterment or improvement work, and the cost of replacing such abandoned property in kind would, if included in a carrier's operating expense accounts for a single year, unduly burden such accounts for that year, the carrier may, if so authorized upon application to the Interstate Commerce Commission, charge such cost to an account entitled 'Property Abandoned, Chargeable to Operating Expenses,' which has been introduced into the Form of General Balance Sheet Statement for this purpose. The phrase 'unduly burden such accounts,' used above, should not be interpreted as meaning that a carrier is at liberty to make charges for abandoned property directly to Operating Expenses, or to Operating Expenses through the account, 'Property Abandoned, Chargeable to Operating Expenses,' in view of its financial ability to make such charges directly in one year and its inability to make such charges in another year. It should be remembered that the charges included in Operating Expenses are designed to cover the current cost of maintaining and operating the property, and that the Property Abandoned accounts are designed to cover any unusual expenditures from year to year.

In case property is abandoned and not replaced, the original cost (estimated, if not known) should be credited to the appropriate additions and betterments accounts and charged, less salvage, to the Profit and Loss Account, to which should also be charged the cost of removing old material and other incidental expenses directly connected with the abandonment."

13. The said Classification of Expenditures for Additions and Betterments for Steam Roads, referred to in the said alleged order, contains the following further provisions under the head "General Instructions:"

"3. All debits and credits to accounts provided in this Classification of Expenditures for Additions and Betterments should be reclassified in accordance with the Classification of Expenditures for Road and Equipment, it being understood that all accounts affecting additions and betterments accounts should be closed finally into road and equipment accounts.

\* \* \* \* \*

5. In case it becomes necessary directly in connection with betterment or improvement work to abandon any property, the cost of replacing the abandoned property in kind, plus the cost of removal but less the value of salvage, should be charged to the appropriate accounts under Operating Expenses. In case, however, the amount so chargeable is large, and its inclusion in a carrier's operating expenses for a single year would unduly burden the operating expense accounts for that year, the carrier may, if so authorized upon application to the Interstate Commerce Commission, charge such cost to the Property Abandoned account provided in the Form of General Balance Sheet Statement, or to the reserve account mentioned in paragraph 6.

6. When property is abandoned and not replaced, the original cost (estimated, if not known) should be credited to the appropriate

additions and betterments accounts and charged, less salvage, to Profit and Loss Account, to which should also be charged all incidental expenses directly connected with the abandonment. If so authorized upon application to the Interstate Commerce Commission, however, a carrier may set up depreciation accounts under 'Maintenance of Way and Structures' for the purpose of creating a reserve to which (instead of Profit and Loss) should be charged the original cost, less salvage, of the property (other than land or equipment) abandoned, and all incidental expenses directly connected with the abandonment.

7. When the use of any land, the cost of which has been included in 'Right of Way and Station Grounds' account or 'Real Estate' account, is discontinued or abandoned, the original cost of the land (estimated, if not known) should be credited to the appropriate accounts under Additions and Betterments and charged, less salvage from sale or other disposal, if any, to Profit and Loss. If the land is retained by the carrier, the salvage should be charged at a fairly appraised value to an appropriate account to be included in the group of accounts described under 'Other Permanent Investments' in the Form of General Balance Sheet Statement.

8. When buildings, structures, or facilities of one class are converted to another class, the original cost (estimated, if not known) of such buildings, structures, or facilities should be credited to the appropriate accounts under Additions and Betterments, and the value in the capacity to which converted should be charged to the account under which the property is now classified. The difference between the original cost, plus the cost of alteration or reconstruction, if any is incurred, less salvage, and the present value of such buildings, structures, or facilities should be charged to Operating Expenses.

\* \* \* \* \*

11. This classification applies exclusively to additions to, or betterments of, existing main and branch lines and their appurtenances and equipment."

The said Classification of Expenditures for Additions and Betterments for Steam Roads, referred to in said alleged order, contains the following provisions under the head "Text of Classification of Expenditures for Additions and Betterments:"

"1. Right of Way and Station Grounds.

To this account should be charged the cost of additional land (of necessary width conformable to depth and slope of excavations and embankments, including borrow pits and waste banks adjoining right of way) acquired for roadbed for additional main tracks; for new roadbed on account of changes of line; for new passing tracks, sidings, and spur tracks, or the extension of existing ones;

15 for new station, terminal, and shop grounds or the enlargement of existing ones, including additional land purchased for ingress to or egress from such grounds; payments for right of way and station grounds on constructed lines, the title to which lands had not been acquired and payment for which had not been

made before the construction accounts were closed; salaries and expenses of counsel, right-of-way agents, engineers, and assistants, when specially assigned to such matters; cost of stakes used to denote right-of-way limits; expenses of appraisals or of juries, commissioners, or arbitrators in condemnation cases; cost of removal of buildings from additional right-of-way or station or terminal grounds purchased; commissions paid to outside parties for purchase of additional right-of-way and grounds for the purposes above described; cost of plats, abstracts, notarial fees, recording deeds, etc. Payments for damages to abutting property caused by the construction of additional tracks, etc., as above described, should also be charged to this account. (See account No. 17, 'Track Elevation, Elimination of Grade Crossings, etc.')

See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.

NOTE A.—Proceeds from the sale of improvements included in a purchase, the total cost of which has been charged to account No. 1, 'Right of Way and Station Grounds,' should be credited to the same account.

NOTE B.—The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

### 5. Grade Revisions and Changes of Line.

To this account should be charged:

Grade Revisions.—(Reduction of grades by cutting down summits and raising sags without materially changing the alignment.) The amount to be charged to this account is the cost of additional grading done, including as a portion of such cost the rent and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools, etc., used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing  
16 grade crossings for farm or country roads, highways, and streets, including crossing gates, highway crossing alarms, and watchhouses.

Changes of Alignment.—(Alteration of alignment for the purpose of reducing curvature, cutting out bridges, tunnels, etc.) The amount to be charged to this account is the excess cost of the grading and bridging done over the cost of replacing in kind the grade, bridges, tunnels, etc., on the portion of the old line that is abandoned.

Changes of Line.—(Construction of new lines for the purpose of improving grade or alignment.) The amount to be charged to this account is the difference between the cost of the new line and the cost of replacing in kind the line abandoned, exclusive of right of way. It includes the cost of engineering, clearing and grubbing, grading, tunnels, bridges, trestles and culverts, ties, rails, frogs, switches, track fastenings, and other track material; ballasting, track-laying, and surfacing; fencing right-of-way; crossings and

signs, interlocking and signal apparatus; telegraph and telephone lines; also cost of tools, rent and expenses of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.

NOTE A. —The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; reballasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection, and moving and relocating telegraph or telephone poles, signals, fences, buildings, etc., should all be charged to the appropriate operating expense accounts.

NOTE B. —The cost of buildings, water and fuel stations, and similar structures on new lines should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate accounts herein provided relating to the different classes of buildings and structures.

\* \* \* \* \*

## 22. Shops, Enginehouses, and Turntables.

To this account should be charged the cost of additional shops, enginehouses, and turntables, and of additional fixtures, facilities, and appurtenances (other than shop machinery and tools) necessary to equip new shops, enginehouses, and turntables; the cost of enlarging the plant and equipment of existing shops, enginehouses, and turntables; also the excess cost of new buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind buildings or structures, and fixtures, facilities, and appurtenances removed.

This account should include the cost of the following buildings or structures when built as parts of or in connection with shops, engine houses, and turntables: car sheds, cinder pits, drop pits, electric light and power plants, out houses, sand houses, scrap bins, storerooms, tracks, and transfer tables. To it should also be charged the cost of the following items incidental to the construction or improvement of the buildings or structures mentioned: architect's fees, beautifying grounds, excavations, foundations, electric fixtures, fences, gas fixtures, grading, heating plants and apparatus, hedges, platforms, sewerage systems, sidewalks; turntable levers, tractors, and stops; water system connections.

See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.

NOTE. —The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.



### 23. Shop Machinery and Tools.

To this account should be charged the cost of additional machinery and tools placed in shops or enginehouses and not replacing other tools and machinery, including foundations therefor, cost of transportation, loading, unloading, and placing machinery in position. This account includes the cost of additional stationary engines and boilers, automatic stokers, ash conveyors, electric generators and motors, switchboards, compressors, shafting, belting, cranes, stationary and portable forges, trip hammers, lifting magnets, and hydraulic, pneumatic, and electric machines, together with all other additional machinery and tools placed in shops and enginehouses, including the necessary small hand tools first to equip a new and additional shop, but not including additional small hand tools furnished to shops or enginehouses already in operation.

To it should also be charged the excess cost of machinery and tools of an improved type or character installed in shops or enginehouses in substitution for machinery and tools of obsolete or inferior type or character over the cost of replacing in kind existing machinery or tools. The excess cost of foundations for new

18 machinery over the cost of replacing in kind the foundations for existing machinery and the cost of unloading and placing the machinery thereon, should be charged to this account.

See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses."

Notice of the said alleged order and classification was given to and received by your Petitioner on August 16, 1909.

On or about May 31, 1910, the Interstate Commerce Commission issued, published and promulgated its "Classification of Expenditures for Additions and Betterments as prescribed by the Interstate Commerce Commission for Steam Roads in accordance with Section 20 of the Act to regulate commerce, First Revised Issue, effective on July 1, 1910." The said Classification of Expenditures for Additions and Betterments purported to be issued and promulgated under the authority of an alleged order of the said Commission claimed to have been entered or adopted on or about May 31, 1910, of which the following is a copy:

"At a General Session of the Interstate Commerce Commission, Held at its Office, in Washington, D. C., on the 31st Day of May, 1910,

#### Present:

Martin A. Knapp, Judson C. Clements, Charles A. Prouty, Francis M. Cockrell, Franklin K. Lane, Edgar E. Clark, James S. Harlan, Commissioners.

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

19 It is ordered, That the Classification of Expenditures for Additions and Betterments for Steam Roads with the text

pertaining thereto; prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form to be hereafter known as First Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved, that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

It is further ordered, That the said Classification of Expenditures for Additions and Betterments, First Revised Issue, with the text pertaining thereto be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of their accounts of expenditures for additions and betterments; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts of expenditures for additions and betterments in conformity therewith; and that a copy of the said First Revised Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

It is further ordered, That the rules contained in the said First Revised Issue of the Classification of Expenditures for Additions and Betterments are, and by virtue of this order do become, the lawful rules according to which the said expenditures for additions and betterments are defined; that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of the accounts of expenditures for additions and betterments of any such carrier; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier or for any person directly in charge of the accounts of any such carrier or of any receiver or operating

trustee of any such carrier to keep any account or record or memorandum of any item of expenditure for additions or betterments except in the manner and form in the said First Revised Issue set forth and hereby prescribed, and except as hereinafter authorized.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in the said First Revised Issue established as may be required for the purposes of any such carrier or of any receiver or operating trustee of any such carrier; or may make assignment of the amount charged to any such primary account to divisions, to its individual lines, or to States; Provided, however, That a list of such subprimary accounts set up or such assignments made by any such carrier or by any receiver or operating trustee of any such carrier be first filed in the office of the Bureau of Statistics and Accounts of this Commission subject to disapproval by the Commission.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier may, in addition to the accounts of expenditures for additions and betterments hereby prescribed, keep any temporary or experimental accounts the purpose of which is to develop economies in expenditures for additions and betterment. Provided, however, That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed; and that any such temporary or experimental accounts shall be open to inspection by the Commission.

It is further ordered, That July 1, 1910, be, and is hereby, fixed as the date on which the said First Revised Issue shall become effective."

The Classification of Expenditures for Additions and Betterments for Steam Roads, referred to in said alleged order of May 31, 1910, contains, among other things, the following provisions under the heading "General Instructions":

4. Property Retired and Replaced.—When property (other than land or equipment), a betterment of which would be chargeable to the accounts of this classification, is abandoned, demolished, or otherwise retired from service for the purpose of or by reason of its replacement by property of like purpose of a better kind or a higher type, the cost of replacing in kind the property so abandoned or withdrawn from service, less the salvage, if any, should be charged to Operating Expense. If, however, a reserve for abandonment, as provided in paragraph 8 of these instructions, or a reserve for accrued depreciation has been created with respect to such property, the reserve account should be first debited with an amount equal to the credit thereto made with respect to the property abandoned or withdrawn and replaced, but if no reserve has been created in advance of the retirement of such property, and the amount chargeable to Operating Expenses is relatively large, so much of the amount as may be authorized under the conditions outlined in paragraph 9 may be carried in suspense for distribution to the operating expenses of succeeding years.

5. Property Retired and not Replaced.—When property (other than equipment), an addition to or a betterment of which would be chargeable to the accounts of this classification, is abandoned or withdrawn from service and not replaced, the cost (estimated, if not known) should be credited to the account provided herein for such property; proper account should be taken of any salvage; the reserve accounts for abandonment and accrued depreciation should be debited with the amounts, if any, previously credited thereto with respect to the property abandoned or withdrawn; and the difference between the salvage plus the reserves and the cost should be charged to Profit and Loss, to which should also be charged any incidental expenses connected with the retirement.

6. Land Sold or Abandoned.—If any land, except land the cost of which may be classified under "Miscellaneous Investments" in the Form of General Balance Sheet Statement, First Revised Issue, is abandoned or its use discontinued, the original cost of the land (estimated, if not known) should be credited to the appropriate accounts

under Additions and Betterments and charged, less salvage from sale or other disposal, if any, to Profit and Loss. If the land is retained by the carrier, it should be charged at a fairly appraised value to an appropriate account to be included under 'Miscellaneous Investments' in the Form of General Balance Sheet Statement, First Revised Issue.

\* \* \* \* \*

22 8. Reserve for Abandonments. If so authorized upon application to the Interstate Commerce Commission, a carrier may set up accounts under Maintenance of Way and Structures in Operating Expenses with respect to important pieces of property (except equipment) to be abandoned, for the purpose of creating such reserves as will, at the time of the abandonment, meet or reduce the amounts otherwise chargeable to Operating Expenses or to Profit and Loss. Upon the abandonment of any property with respect to which a reserve has been created, such portion of the amount otherwise chargeable to Operating Expenses or to Profit and Loss as will equal the amount previously credited to the reserve account should be debited thereto.

9. Distribution of Charges for Abandoned Property. In case the amount chargeable to operating expenses for property abandoned directly in connection with improvements is relatively large, and its inclusion in a carrier's operating expenses for a single year would unduly burden those accounts for that year, a carrier may, if so authorized upon application to the Interstate Commerce Commission, charge so much of the cost as may be authorized to an account 'Property Abandoned, Chargeable to Operating Expenses,' as provided in the Form of General Balance Sheet Statement, First Revised Issue. The amount so charged should thereafter be apportioned to the operating expenses of succeeding years, the number of which will be determined when permission to use the account is given.

\* \* \* \* \*

11. Definition of 'Cost of Replacing in Kind.' By the term 'Cost of replacing in kind,' as used in this classification is meant the cost, at the current prices of labor and material, of renewing such property by the construction or installation of other property substantially similar in capacity, service, and accessories, and having a physical condition and an expectation of life in service equal to that of the replaced property when acquired, or, if improved after acquisition, when in its best condition. It should not be construed as requiring an estimate based upon the current prices of material identical with that of which the thing abandoned was constructed,

23 particularly when such material is no longer obtainable except at prohibitive prices and would not be used if a renewal of the property without betterment were undertaken.

\* \* \* \* \*

14. Reclassification of Charges.—The net increase or decrease in the investment as reflected by these accounts should be reclassified in accordance with the accounts provided in the Classification of Ex-

penditures for Road and Equipment, it being required that all items affecting additions and betterments be closed into the Road and Equipment accounts.

\* \* \* \* \*

18. Cancellation of Conflicting Previous Instructions. — This Classification supersedes the Classification of Expenditures for Additions and Betterments for Steam Roads, First Issue, and the rules herein provided supersede conflicting instructions in any other classifications previously issued."

The Classification of Expenditures for Additions and Betterments for Steam Roads, referred to in said Alleged order of May 31, 1910, contains, among other things, the following further provision under the heading "Text of Classification of Expenditures for Additions and Betterments":

#### "A. 1. Right of Way and Station Grounds"

To this account should be charged the cost of land (of necessary width conformable to depth and slope of excavations and embankments, including borrow pits and waste lands adjoining right of way) acquired for road-bed for additional main tracks, for new road-bed on account of change of line, and for the construction of new and the extension of existing sidings and spur tracks; for additional station, terminal, and shop grounds, including land for ingress to or egress from such grounds; also for additional docks or wharves, and the cost of riparian or water rights necessary therefor.

The cost of stakes used to denote right of way limits; expenses of appraisals or of juries, commissioners, or arbitrators in condemnation cases; cost of removal of buildings from additional right of way or station, shop and terminal grounds purchased; commissions paid to outside parties for the purchase of additional right of way and grounds for the purposes above described; notarial fees, cost of plats, abstracts, recording deeds, salaries and expenses of counsel, right of way agents, engineers, and assistants, when they are specially assigned to duties pertaining to the acquisition of right of way and station grounds; payments for right of way and station grounds on constructed lines, the title to which lands had not been acquired and payment for which had not been made before the construction accounts were closed; and payments for damages to abutting property caused by the construction of additional tracks, etc., as above described, should also be charged to this account. (See account A17, 'Elimination of Grade Crossings,')

NOTE A. — Proceeds from the sale of improvements included in a purchase of real estate, the cost of which is included in 'Right of Way and Station Grounds,' should be credited to this account.

NOTE B. — The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

\* \* \* \* \*



## A 5. Grade Reductions and Changes of Line.

To this account should be charged:

For grade reductions (cutting down summits and raising sags without materially changing the alignment): The cost of additional grading, including the rent and cost of operation of steam shovels and work trains, building temporary tracks for steam shovels and grading outfit, tools used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, or streets, including crossing gates, alarms, and watch-houses; less the cost of replacing in kind grades or other property abandoned or removed.

For changes of alignment (alteration of alignment for the purpose of reducing curvature, cutting out bridges, tunnels, etc.): The excess cost of the grading, bridging, tunnelling, etc., necessary for the change over the cost of replacing in kind the grade, bridges, tunnels, etc., abandoned.

For changes of line (construction of new lines for the purpose of improving grade or alignment): The difference between the cost of the new line and the cost of replacing in kind the line abandoned, excluding the cost of right-of-way for both lines, but including the cost of engineering, clearing, grubbing, and grading; tunnels, bridges, trestles, and culverts; ties, rails, frogs, and switches, track fastenings and appurtenances; ballasting, tracklaying, and surfacing, fencing right-of-way; crossings and signs, interlocking and signal apparatus, telegraph and telephone lines, also cost of tools, rent and cost of operation of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

NOTE A. The cost of such grading as is necessary to restore banks or cuts to the original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting traffic while passing over the tracks; rebalasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection, and moving and re-erecting telegraph or telephone poles, signals, fences, buildings, etc., should all be charged to the appropriate operating expense accounts.

NOTE B. The cost of buildings, water and fuel stations, and similar structures on a changed line should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate accounts herein provided for the different classes of buildings and structures.

## A 23. Shops, Enginehouses, and Turntables.

To this account should be charged the cost of additional shops, enginehouses, and turntables, and of additional fixtures, facilities,

and appurtenances (other than shop machinery and tools) necessary to equip them; also the excess cost of new buildings or structures or parts of buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind like property removed.

This account should include the cost of the following buildings or structures when built as parts of or for use in connection with shops, enginehouses, and turntables: Car sheds, cinder pits, drop pits, electric light and power plants, outhouses, sand houses, scrap bins, storehouses, tracks, and transfer tables; also the cost of the following items incidental to the construction or improvement of the buildings or structures mentioned: Architect's fees, beautifying grounds, excavations, foundations, electric fixtures, fences, gas fixtures, grading, heating plants and apparatus, hedges, platforms, sewerage systems, sidewalks; turntable levers, tractors and stops; and water system connections.

NOTE.—The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

## 26

## A 24. Shop Machinery and Tools.

To this account should be charged the cost of machinery and tools installed in shops or engine-houses and not replacing other tools and machinery, including foundations therefor, the cost of transportation, loading, unloading, and placing machinery in position. This account includes the cost of additional stationary engines and boilers, automatic stokers, ash conveyors, electric generators and motors, switchboards, compressors; shafting, belting; cranes; stationary and portable forges; trip hammers, lifting magnets, and hydraulic, pneumatic, and electric machines; and other machinery and tools installed in shops and enginehouses, including the necessary small hand tools first to equip them, but not including additional small hand tools furnished to shops or enginehouses already in operation.

To it should also be charged the excess cost of machinery and tools (except hand and other small portable tools) of an improved type or character installed in shops or enginehouses over the cost of replacing in kind machinery or tools abandoned. The excess cost of foundations for new machinery over the cost of replacing in kind the foundations for existing machinery and the cost of unloading and placing the machinery thereon, should be charged to this account.

On or about May 31, 1910, the Interstate Commerce Commission issued, published, and promulgated its "Form of General Balance Sheet Statement, as prescribed by the Interstate Commerce Commission for Steam Roads in accordance with Section 20 of the Act to regulate commerce, First Revised Issue, effective on June 15, 1910."

The said Form of General Balance Sheet Statement purported to be issued and promulgated under the authority of an alleged order of the said Commission, claimed to have been entered or adopted on or about May 31, 1910, of which the following is a copy:

27 "At a General Session of the Interstate Commerce Commission, Held at its Office, in Washington, D. C., on the 31st Day of May, 1910.

Present: Martin A. Knapp, Judson C. Clements, Charles A. Prouty, Francis M. Cockrell, Franklin K. Lane, Edgar E. Clark, James S. Harlan, Commissioners.

The subject of a Uniform General Balance Sheet Statement for the use of carriers making reports to the Commission, and of the Ledger Accounts immediately pertaining thereto, being under consideration, the following order was entered:

It is ordered, That the Form of General Balance Sheet Statement, with the classification of the accounts involved in such statement and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form, to be hereafter known as Form of General Balance Sheet Statement, First Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original thereof.

It is further ordered, That the said Form of General Balance Sheet Statement, First Revised Issue, with the classification of the accounts involved in such statement and the text pertaining thereto, be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of all transactions reflected in the said Form of General Balance Sheet Statement, First Revised Issue; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts involved in the said

28 Form of General Balance Sheet Statement, First Revised Issue, in conformity therewith; and that a copy of the said Form of General Balance Sheet Statement, First Revised Issue, be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

It is further ordered, That the rules contained in the said Form of General Balance Sheet Statement, First Revised Issue, are, and by virtue of this order do become, the lawful rules according to which all entries in the accounts involved in such statement are defined; that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of all transactions pertaining to, or reflected in, the said Form of General Balance Sheet Statement, First Revised Issue; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier, or for any person

directly in charge of the accounts of any such carrier, or of any receiver or operating trustee of any such carrier, to keep any account or record or memorandum of any transactions pertaining to, or reflected in, the said Form of General Balance Sheet Statement, First Revised Issue, except in the manner and form hereby prescribed; Provided, however, That nothing in this order shall be construed as depriving a carrier of the right to make whatever amendments of balance-sheet entries it may deem proper for the information of stockholders or of officials who have the management of its property.

It is further ordered, That June 15, 1910, be, and is hereby, fixed as the date on which the said Form of General Balance Sheet Statement, First Revised Issue, shall become effective."

The text explanatory of the accounts embodied in the said Form of General Balance Sheet Statement, referred to in said last mentioned alleged order of May 31, 1910, contains among other things, the following provisions:

"B 21. Property Abandoned, Chargeable to Operating Expenses.

This account is intended as a suspense account to which may be charged certain costs representing important pieces of property abandoned because of improvement or betterment work when the cost of such property would, if included in the operating expenses for a single year, unduly burden such accounts for that year. It is to be used only after permission of the Interstate Commerce Commission has been asked and given and is not to be applied to lands abandoned or to equipment retired from service. Amounts included in the account are to be redistributed to operating expenses through a period of years, the number of which will be determined when permission to use the account is granted, and the balance remaining unextinguished on the date of the balance sheet should be included herein.

To this account (when authorized by the Interstate Commerce Commission) may be charged such amounts as are required by the Classification of Expenditures for Additions and Betterments to be charged to operating expenses for property abandoned because of additions and betterments work.

NOTE.—The phrase "unduly burden such accounts," used above, should not be interpreted as meaning that a carrier is at liberty to make charges for abandoned property directly to operating expenses, or to operating expenses through the account "Property Abandoned, Chargeable to Operating Expenses," in view of its financial ability to make such charges directly in one year and its inability to make such charges in another year."

On or about June 3, 1907, the Interstate Commerce Commission issued, published, and promulgated its "Classification of Operating Expenses, as prescribed by the Interstate Commerce Commission in accordance with Section 20 of the Act to regulate commerce," Third Revised Issue, effective July 1, 1907. The said Classification

of Operating Expenses purported to be issued and promulgated under the authority of an order of the said Commission, entered or adopted on or about June 3, 1907.

On or about June 1, 1908, the Interstate Commerce Commission issued, published, and promulgated its "Supplement to the Third Revised Issue of the Classification of Operating Expenses, as prescribed by the Interstate Commerce Commission for Steam Roads in accordance with Section 20 of the Act to regulate commerce, effective on July 1, 1908." The said Supplement to the Third Revised Issue of the Classification of Operating Expenses for Steam Roads purported to be issued and promulgated under the authority of an order of the said Commission, entered or adopted on or about June 1, 1908.

Fifth, At the time said revisions of grade were contemplated, projected and made, your Petitioner had no funds available to defray the cost thereof, save and except the portion of the proceeds of said bonds appropriated therefor, as aforesaid; and the cost of said improvements was defrayed solely from the proceeds of said bonds. As stated above, your Petitioner at all times intended and claimed the right to enter and carry in its property accounts items accurately recording the facts as to these expenditures, including the disclosure of the sources from which these funds were derived, and to increase its property accounts by the addition of a sum equal to the aggregate of these expenditures, less the salvage from materials in the abandoned sections not transferred to or used in the new construction.

Your Petitioner is informed and believes and so alleges that had said grade reductions at said six portions of the line been made upon the original roadbed, the said several alleged orders and classifications of the Interstate Commerce Commission would have permitted, sanctioned and required the charging of the cost thereof, to wit, approximately \$1,230,318.99, without substantial reduction, to your Petitioner's property accounts and would have justified it in the issuance and sale of capital stock or evidences of capital debt to the approximate extent of said sum.

Your Petitioner is also informed and believes and so alleges that the said alleged orders and classifications of the Interstate Commerce Commission require in substance and effect that your Petitioner may enter in its property accounts the said sum of approximately \$634,183.74 representing the actual expenditure made by it in revising its grade by changes of line in the manner above set forth, but that your Petitioner must reduce its property accounts by the estimated replacement value (less salvage) of the portions of its line abandoned in making said revisions and that such reduction shall be effected by charging the said amount to the operating expense and profit and loss accounts of your Petitioner, extending the said charge to operating expenses over a term of years to be determined by the said Commission. That is to say, the regulations of the said Commission require that as a result of the said last mentioned expenditures, for the improvement of its property, the approximate net addition to the property accounts of your Petitioner shall be only

\$234,747.74 which amount is reached through the following process of computation:

At the close of the taking of testimony on December 16, 1912, on motion of the Petitioner, it was ordered that the first paragraph of page 31 of the Petition be amended so as to read as follows:

[On margin:] See order entered Dec. 24, 1912.

Your Petitioner is also informed and believes and so alleges that the said alleged orders and classifications of the Interstate Commerce Commission require that in accounting for said expenditure of approximately \$334,183.74 made by it in revising its grades by changes of line in the manner above set forth, a charge shall be made to Operating Expenses and Profit and Loss Accounts of the estimated replacement cost (less salvage) of the portions of its line abandoned in making said revisions and that the approximate net addition to the property accounts of your Petitioner in connection with said expenditure of \$334,183.74 shall be only \$234,747.74, which amount is reached through the following process of computation:

Cost of reducing grade to .5 of 1 per cent. on the new locations, exclusive of old material released and used.	\$ 334,183.74
Value of old material released and used.	91,685.00
Gross addition to Property Accounts.	\$ 242,498.74
Deduct estimated cost to replace in kind the line abandoned	491,121.00
32 Net addition to Property Accounts, subject to capitalization	\$ 234,747.74

The value of old material released and used in the work was approximately \$91,685; and the estimated cost to replace in kind the abandoned portions of the line is \$491,121.

Your Petitioner avers that in fact the value of its property was increased by reason of the said expenditure of approximately \$334,183.74 by an amount not less than said sum; that the value of its property was not diminished and has not been diminished by the abandonment of said portions of its line in an amount equal to their estimated replacement cost or by any other amount; that your Petitioner did not incur, in connection with said revisions of grade and by reason of the incidental abandonment of said portions of its line, an operating expense equal to their replacement cost, or any operating expense whatsoever; and that the entry of items indicating such a diminution in the value of its property and recording such an operating expense would render said accounts inaccurate and untruthful.

Your Petitioner is informed and believes and so alleges that the said Classification of Operating Expenses promulgated by the Interstate Commerce Commission, including all supplements thereto, does not provide any account or accounts in which such charges required

as aforesaid to be made to your Petitioner's operating expense accounts may be appropriately entered.

The enforcement of said alleged orders, classifications and regulations would, therefore, wrongfully and unlawfully prevent your Petitioner from showing a net addition to its property accounts of approximately \$634,183.74 as it is justly entitled to do, and would compel your Petitioner to show as the net result of its expenditures for said improvements, an approximate net addition to its property accounts of only \$234,747.74.

Exhibit "B" hereto annexed and hereby made a part hereof, sets forth the details of the foregoing computation and the manner in which your Petitioner's accounts would be affected by the requirements of the said alleged orders and classifications of the Interstate Commerce Commission as the result of the aforesaid expenditure of approximately \$634,183.74.

Sixth. Not only do the said alleged orders and regulations of the Interstate Commerce Commission operate unreasonably and injuriously to the interests of your Petitioner in respect of the above mentioned improvements already made by your Petitioner, but your Petitioner has determined also to reduce the grade upon other portions of its line to a maximum of .5 of 1 per cent, through certain changes of line in cases where such method is the more economical. The said work is now in progress and the expenditure therefor is expected to aggregate \$1,200,000. Your Petitioner is informed and believes that the economy and saving to be effected by resorting to changes of line in this additional program of grade reduction will be relatively as great as at the six portions of the line above referred to.

The revisions of grade through changes of location which have already been effected constitute only a part of the work of grade revision which your Petitioner has been carrying on during the past two years, the expenditure already made by your Petitioner in revisions of grade through the ordinary method of raising or lowering the existing roadway aggregating approximately \$1,200,000.

Seventh. Your Petitioner alleges that the Constitution of the United States confers upon Congress no power to regulate in the manner attempted as above set forth the internal affairs of your Petitioner and that Congress has no power or authority to delegate, and has not delegated, to the Interstate Commerce Commission the right to regulate in the manner attempted as above set forth the internal affairs of your Petitioner, and that such jurisdiction as the said Commission is entitled to exercise in the premises does not in any manner extend to or embrace the ascertainment or determination of the capital of your Petitioner or by placing a valuation upon its property, or otherwise, to regulate the issues of capital of your Petitioner; that the right of your Petitioner to keep its books of account in such manner as accurately to show the amount of its capital is a property right, and that your Petitioner is lawfully entitled to keep its accounts in such manner as to show the amounts expended

in the exercise of sound business judgment on its property for capital purposes.

Your Petitioner alleges that in so far as the above mentioned alleged orders and classifications of the Interstate Commerce Commission require your Petitioner to charge to its operating expense and profit and loss accounts the estimated replacement value (less salvage) of the portions of its line of railroad abandoned as an incident to improvement in grade, said alleged orders and classifications are unreasonable and beyond the power and authority of the Commission, and are null and void; and that the enforcement of the requirements of said orders and classifications in said

35 particular would be a violation of the Fifth Article of the Amendments to the Constitution of the United States in that it would deprive citizens of the United States, and particularly your Petitioner, of property without due process of law.

Eighth, Beginning in October, 1909, your Petitioner has made repeated efforts to secure from the Interstate Commerce Commission a ruling whereby the Commission would determine either that the above mentioned orders are invalid, so far as they apply to the circumstances above set forth, or that the said circumstances present an exceptional situation not embraced within the purview and scope of said orders and classifications. The Interstate Commerce Commission has refused and failed up to the present time to grant your Petitioner any relief whatever in the premises, but on the contrary has notified your Petitioner that it must comply with the above mentioned requirements and that it must charge to its operating expense and Profit and Loss accounts the estimated replacement value (less salvage) of the portions of your Petitioner's line abandoned as an incident to the making of grade reductions.

Ninth, As a second ground of complaint, your Petitioner states that it has a shop and terminal plant at Shreveport, Louisiana. The said shop, with its equipment, is not worn out or obsolete, and is capable with ordinary running repairs of performing for an indefinite term the functions for which it was originally constructed.

Your Petitioner has determined as an integral part of an extensive program of interrelated improvements to construct, and is now engaged in constructing, a new and enlarged shop and terminal 36 plant at Shreveport on a new and different location from that of the shop and terminal plant now existing, which last mentioned shop and terminal plant are incidentally to be abandoned.

The value (less salvage) of the said Shreveport shop and terminal plant so to be abandoned, is approximately \$100,000.

Your Petitioner intends, in the exercise of reasonable discretion, to charge the aforesaid value of the said shop and terminal plant when abandoned (less salvage) against its accumulated surplus as represented in its Profit and Loss account. Your Petitioner, on June 30, 1911, had and now has an accumulated surplus represented in its Profit and Loss account aggregating approximately \$1,580,000.

Your Petitioner is informed and believes and so alleges that the said alleged orders and classifications of the Interstate Commerce



Commission unreasonably and unlawfully require that the estimated replacement value (less salvage) of the said shop and terminal plant now existing, shall be charged to your Petitioner's operating expense accounts in monthly installments distributed over a period of time to be designated by the said Commission.

Your Petitioner alleges that in fact the value of its property will be enlarged by reason of the construction of the said new shop and terminal plant at Shreveport by an amount not less than the sum expended or to be expended therefor; that the value of its property has not been, and will not be, diminished by the abandonment of the said shop and terminal plant now existing, in an amount equal to their replacement value, or by any other amount; that your Petitioner has not incurred, and does not expect to incur, in connection

with the said construction and abandonment an operating  
37 expense equal to the replacement value of the said last mentioned shop and terminal plant, or any operating expense whatsoever; and that the entry of items recording such an operating expense would render its accounts inaccurate and untruthful; and that insofar as the above mentioned orders and classifications require that the estimated value of the abandoned shop and terminal (less salvage) shall be charged to operating expense accounts, said orders and classification are unreasonable and beyond the power and authority of the Interstate Commerce Commission, and are null and void; and that the enforcement of the requirements thereof in said particular would be a violation of the Fifth Article of the Amendments to the Constitution of the United States in that it would deprive citizens of the United States and particularly your Petitioner, of property without due process of law.

Tenth. Your Petitioner has endeavored to secure from the Interstate Commerce Commission a ruling whereby the Commission would determine that the above mentioned orders are invalid so far as they purport to require that the value of said abandoned shop and plant (less salvage) shall be charged to its operating expense accounts instead of to its accumulated surplus. The Interstate Commerce Commission has refused and failed up to the present time to grant your Petitioner any relief whatever in the premises, but on the contrary has notified your Petitioner that it must comply with the above mentioned requirements and must charge the value (less salvage) of said shop and plant when abandoned to your Petitioner's operating expense accounts.

Eleventh. Your Petitioner avers that under and pursuant  
38 to the provisions of its Articles of Association, dividends upon its preferred capital stock may only be declared from and out of current surplus revenues; that your Petitioner has continuously declared and paid dividends on its preferred capital stock during the past five years; that if its net revenues are maintained at or about the current rate it will be enabled to continue payment of such dividends; that the said charges to operating expense accounts, if made by your Petitioner in accordance with the above mentioned alleged orders and requirements of the Interstate Com-

merce Commission, might and probably would render necessary the discontinuance, wholly or in part, of such dividends; and that such result would work great and irreparable damage to the credit and financial repute of your Petitioner.

Your Petitioner further avers that its credit and ability to dispose of its bonds, as well as the price and market value thereof, are in considerable measure dependent upon the amount of your Petitioner's surplus income above the amount necessary to pay interest on its funded debt; and that the said alleged orders of the said Commission would effect an apparent reduction in the surplus income, which would irreparably damage the credit and financial repute of your Petitioner.

Wherefore your Petitioner prays judgment:

(1) That the above mentioned orders and classifications entered, adopted and promulgated by the Interstate Commerce Commission insofar as they may require or tend to require your Petitioner to charge against its earnings the estimated replacement value (less salvage) of the above mentioned six parcels of railroad abandoned, only as an incident to grade reduction as herein set forth, and in effect prevent your Petitioner from carrying in its capital or  
39 property accounts the full undiminished cost (less net salvage) of the said grade revisions, be declared unreasonable, without the power or authority either of Congress or the Interstate Commerce Commission, and in violation of the provisions of the Fifth Article of the Amendments to the Constitution of the United States as a deprivation of property without due process of law, and for said reasons null and void.

(2) That the said orders and classifications of the Interstate Commerce Commission insofar as they prevent your Petitioner from charging the estimated value (less salvage) of the said shops and terminal plant at Shreveport to accumulated surplus and require and compel your Petitioner to charge the same to its operating expense accounts, be adjudged and declared unreasonable, without the power or authority either of Congress or the Interstate Commerce Commission, and in violation of the provisions of the Fifth Article of the Amendments to the Constitution of the United States as a deprivation of property without due process of law, and for said reasons null and void.

(3) That a judgment be made and entered herein forever enjoining the United States of America from in any manner enforcing or attempting to enforce the said provisions of the above mentioned orders and classifications of the Interstate Commerce Commission.

(4) That a temporary or interlocutory order or decree be made and entered herein suspending, during the pendency of this suit, the operation of said orders and classifications so far as the same apply  
40 or are claimed to apply to your Petitioner in respect of the facts and circumstances set forth in this petition.

(5) That your Petitioner may have such other and fur-

ther relief in the premises as may be agreeable to equity and as may seem meet to this Honorable Court.

And your Petitioner will ever pray, etc.

THE KANSAS CITY SOUTHERN  
RAILWAY COMPANY,

[SEAL.] By JOB A. EDSON, *President*,

Attest:

GASTON C. HAND, *Secretary*,

SAMUEL UNTERMYER,

SAMUEL W. MOORE,

*Of Counsel*,

41 STATE OF NEW YORK.

*County of New York, ss:*

Job A. Edson, being duly sworn, says:

That he is an officer, to wit, the President of The Kansas City Southern Railway Company, the Petitioner named in the foregoing petition; that he has read the same and knows the contents thereof, and that the same is true of his own knowledge except as to the matters therein stated to be alleged upon information and belief, and that as to those matters he believes it to be true.

JOB A. EDSON.

Sworn to before me this 15th day of November, 1911.

[SEAL.]

RAPHAEL BRILL,

*Notary Public, No. 109, New York County.*

## EXHIBIT A.

	Between MP 274.94 and MP 277.71—2.77 MI.	2.86 MI.	Now line constructed.	Cost of replacing old line to 0.297 grade.	Cost of replacing in kind old line abandoned.	Cost of constructing new line with new material.	Salvage from abandoned line not used in construction of new line, taken into stock.	Value of old material used.	Estimated cost of constructing new line using old material.	All other costs.
	MP 274.94 and MP 277.71—2.77 MI.	2.86 MI.		\$216,872.97	\$2,000.00	\$87,000.00	\$1,218.00	\$12,210.00	\$81,051.00	
"	"	"		327,331.40	91,845.00	115,727.55	940.00	14,750.00	97,536.42	
"	"	"		192,772.42	126,634.00	192,773.20	290.00	23,000.00	161,781.35	
"	"	"		141,943.95	81,000.00	133,464.00	1,275.00	17,640.00	110,500.85	
"	"	"		150,299.00	61,136.00	100,812.90	212.00	13,925.00	83,070.40	
"	"	"		192,180.25	12,024.00	112,342.25	920.00	10,070.00	99,631.95	
	20.62 MI.	21.63 MI.		\$1,290,318.90	\$491,121.00	\$675,000.00	\$6,751.00	\$91,087.00	\$634,183.74	

Old line abandoned.

## EXHIBIT B.

## Charge to Grade Reductions and Changes of Line:

## Cost of New Line, viz.:

Cash expended.....	8634,183.74	
Material transferred from old line.....	91,685.00	
	8725,868.74	
Less cost of new right of way.....	11,342.00	
		\$714,526.74

## Debit Value of Abandoned Line, viz.:

Estimated cost to replace in kind.....	8491,421.00	
Less value of abandoned right of way.....	8,168.00	
		482,953.00

Grade Reductions and Changes of Line..... 8231,573.74

## Charge to Right of Way and Station Grounds:

Cost of new right of way.....	811,342.00	
Less value of abandoned right of way.....	8,168.00	
		3,174.00

## Charge to Materials and Supplies Account:

Material released from abandoned line and not employed in the new.....		4,784.00
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## Charge to Operating Expense Accounts:

Value of abandoned line less right of way.....	8482,953.00	
Less material transferred to new line.....	891,685.00	
Less material not employed in new line.....	4,784.00	
	96,469.00	
		386,484.00

## Charge to Profit and Loss Account:

Value of abandoned line less right of way.....	8482,953.00	
--	-------------	--

Cash Expended for Grade Reduction..... 8634,183.74

*Order Amending Petition.*

(Entered December 24, 1912.)

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Corporation,  
Petitioner,

vs.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervener.

This cause having come on for the taking of testimony before Judge Carland on the 16th day of December, A. D. 1912, and the petitioners having been granted leave to amend their petition,

It is now, this 16th day of December, A. D. 1912, ordered that the petition herein be and it is hereby amended by striking out of said

petition all of the first paragraph on page 31 and inserting in lieu thereof the following:

"Your Petitioner is also informed and believes and so alleges that the said alleged orders and classifications of the Interstate Commerce Commission require that in accounting for said expenditure of approximately \$634,183.74 made by it in revising its grades by changes of line in the manner above set forth, a charge shall be made to Operating Expenses and Profit and Loss Accounts of the estimated replacement cost (less salvage) of the portions of its line abandoned in making said revisions and that the approximate net addition to the property accounts of your Petitioner in connection with said expenditure of \$634,183.74 shall be only \$234,747.74, which amount is reached through the following process of computation:"

By the court:

JOHN E. CARLAND,

*Judge, United States Commerce Court.*

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In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Corporation,

v.

THE UNITED STATES OF AMERICA.

*Answer of the United States.*

(Filed Mar. 1, 1912.)

Comes now the United States of America, respondent, by its counsel, not waiving, but insisting upon the insufficiency of the petition for the reasons heretofore stated in its motion to dismiss the same, and answers as follows:

# I.

The full text of the "First Issue of the Classification of Expenditures for Additions and Betterments" is contained in Exhibit A attached to the answer herein of the Interstate Commerce Commission, which exhibit this respondent begs leave here to incorporate by reference.

The full text of the "First Revised Issue of the Classification of Expenditures for Additions and Betterments" is contained in Exhibit B attached to the answer herein of the Interstate Commerce Commission, which exhibit this respondent begs leave here to incorporate by reference.

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The full text of the "First Revised Issue of the Form of General Balance Sheet Statement" is contained in Exhibit C attached to the answer herein of the Interstate Commerce Commission, which exhibit this respondent begs leave here to incorporate by reference.

The full text of the "Third Revised Issue of the Classification of Operating Expenses" is contained in Exhibit D attached to the answer herein of the Interstate Commerce Commission, which exhibit this respondent begs leave here to incorporate by reference.

The full text of the "Supplement to the Third Revised Issue of the Classification of Operating Expenses" is contained in Exhibit E attached to the answer herein of the Interstate Commerce Commission, which exhibit this respondent begs leave here to incorporate by reference.

## II.

The respondent denies that the Interstate Commerce Commission acted arbitrarily in promulgating the orders referred to in the petition, or any of them, or any part of them, but on the contrary alleges that it acted only after full consideration of all points of view affecting the situation, and after full consideration of all the facts pertinent to the situation, and after consultation with the persons conversant with the methods, practices, and requirements of railway accounting, and particularly after notice to and conference with the Association of American Railway Accounting Officers, which is an association organized by common carriers operating steam roads subject to the act to regulate commerce, for the purpose of considering and formulating a system of uniform accounts; and that, as this respondent is informed and believes, the petitioner was at the time of such notification and conference a member of said association, being represented therein by its vice president and auditor, and participated in said conferences.

## III.

This respondent further denies that the action of the commission was unreasonable or required the making of untruthful statements in accounts, but on the contrary, the commission fully considered the question of what would constitute a reasonable and truthful method of accounting, and in the light of all the information before it, as above stated, and after careful deliberation thereon, decided that the method of accounting established by it as aforesaid, was a reasonable, truthful, and proper method. This conclusion furthermore represented the consensus of opinion of the said association, and the consensus of the whole body of information on the subject, which, as aforesaid, was collected and considered by the commission before it took the action.

## IV.

This respondent further alleges, with particular reference to the allegations of the fourth paragraph of the petition, that the petitioner had notice that the said classifications were proposed for adoption and were under consideration prior to the petitioner's determination to make the revision of grades referred to in the petition, and also prior to the financing thereof.

## V.

This respondent further alleges that even if the petitioner has no ground of grievance against the order of the commission, it has exhausted its remedies before the commission.

And now, having fully answered this petition, this respondent prays that the said petition be dismissed at the petitioner's cost, and for such other and further orders as may be appropriate in the premises.

WINFRED T. DENISON,

*Assistant Attorney General,*

March, 1912,

THURLOW M. GORDON,

*Special Assistant to the Attorney General,*

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In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

v.

UNITED STATES OF AMERICA, Respondent, and INTERSTATE COMMERCE COMMISSION, Intervening Respondent.

*Motion to Extend Time within which to File Motions to Dismiss or Answers.*

(Filed December 12, 1911.)

Come now the United States, Respondent, and the Interstate Commerce Commission, Intervening Respondent, and move the Court to extend the time to and including January 10, 1912, within which the said respondent and the said intervening respondent may file motion to dismiss the petition in the above entitled cause, or their answers to the petition, as the case may be.

BLACKBURN ESTERLINE,

*Special Assistant to the Attorney General,*

CHAS. W. NEEDHAM,

*Solicitor for Interstate Commerce Commission,*



50 In the United States Commerce Court,

No. 56,

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

v.

UNITED STATES OF AMERICA, Respondent, and INTERSTATE COMMERCE COMMISSION, Intervening Respondent,

*Under Extending Time within which to File Motions to Dismiss or Answer.*

(Entered December 12, 1911.)

On motion made and filed by counsel for the United States and counsel for the Interstate Commerce Commission, and good cause being shown, it is ordered that the time within which the respondent and the intervening respondent may file their motions to dismiss the petition in the above entitled cause, or their answers to the petition, as the case may be, be and the same is hereby extended to and including January 10, 1912.

MARTIN A. KNAPP,

*Presiding Judge.*

51 In the United States Commerce Court,

No. 56,

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

v.

UNITED STATES OF AMERICA, Respondent, and INTERSTATE COMMERCE COMMISSION, Intervening Respondent.

*Motion to Extend Time within which to Plead to the Petition.*

(Filed January 10, 1912.)

Come now the United States, Respondent, and the Interstate Commerce Commission, Intervening Respondent, by their respective solicitors, and move the Court to extend the time to and including January 25, 1912, within which the said respondent and the said intervening respondent may plead to the petition in the above entitled causes.

BLACKBURN ESTERLINE,

*Special Assistant to the Attorney General.*

CHARLES W. NEEDHAM,

*Solicitor for Interstate Commerce Commission.*

In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

v.

UNITED STATES OF AMERICA, Respondent, and INTERSTATE COMMERCE COMMISSION, Intervening Respondent.

*Order Extending Time within which to Plead to the Petition.*

(Entered January 10, 1912.)

On motion therefor made and filed by counsel for the United States and counsel for the Interstate Commerce Commission, a good cause being shown, it is ordered that the time within which the respondent and the intervening respondent may plead to the petition in the above entitled cause, be and the same is hereby extended to and including January 25, 1912.

January 10, 1912.

MARTIN A. KNAPP,

*Presiding Judge.*

In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner.

v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervening Respondent.

*Answer of the Interstate Commerce Commission.*

(Filed January 22, 1912.)

The Interstate Commerce Commission, intervening respondent in the above-entitled cause, now and at all times hereafter saving and reserving to itself all and all manner of benefit and advantage of exception to the many errors and insufficiencies in the petitioner's petition filed herein, for answer thereunto, or to so much or such parts thereof as this respondent is advised is material for it to make answer unto, answers and says:

## I.

This respondent admits that the allegations contained in the first paragraph of said petition are true.

## II.

This respondent has no knowledge or information, excepting the statements made to it by the petitioner, concerning the matters and things, or of any of them, set forth in the second and third paragraphs of said petition and therefore neither admits nor denies the same but calls for strict proof thereof if the court shall deem the same relevant and material. But this respondent alleges that the matters and things, and each of them respectively, set forth in said paragraphs, if true, are not, nor are any of them, material or relevant to the determination of the matter in controversy in this suit.

## III.

This respondent answering the fourth paragraph of said petition admits the making and promulgation of the order dated June 21, 1909, effective July 1, 1909, referred to in said paragraph; and this respondent files herewith as Exhibit A, the printed issue containing true copies of said order, the Introductory Letter, General Instructions, and the text of Classification of Expenditures for Additions and Betterments, for Steam Roads, First Issue, referred to, and in part set forth, in said paragraph.

Further answering said paragraph four, this respondent admits that on the 31st day of May, 1910, this respondent issued and promulgated the order, referred to in said paragraph, dated May 31, 1910, effective July 1, 1910, together with the Classification of Expenditures for Additions and Betterments, for Steam Roads, First Revised Issue, a printed issue of which, containing true copies of said last-mentioned order, the Introductory Letter, the General Instructions, and the text of Classification of Expenditures for Additions and Betterments, First Revised Issue, referred to in said paragraph, is hereto attached, marked Exhibit B.

Further answering said paragraph four, this respondent admits that on May 31, 1910, it issued and promulgated its order adopting and prescribing a form of General Balance Sheet Statement, for Steam Roads, effective June 15, 1910, a printed issue containing true copies of said order, the Introductory Letter, Explanatory Note, and text explanatory of Accounts Appearing in the General Balance Sheet Statement is hereto attached, marked Exhibit C.

Further answering said paragraph four, this respondent admits that on June 3, 1907, it issued and promulgated its Classification of Operating Expenses in accordance with section 20 of the act to regulate commerce, third revised edition, effective July 1, 1907. A printed issue containing a true copy of the same is hereto attached, marked Exhibit D.

Further answering said paragraph four, this respondent admits that on June 1, 1908, it published and promulgated its supplement to the third revised issue of the Classification of Operating Expenses in accordance with section 20 of the act to regulate commerce, effective July 1, 1908. A printed issue containing a true copy thereof is hereto attached, marked Exhibit E.

Further answering said fourth paragraph, this respondent denies each and every allegation thereof, excepting as said allegations, or any of them, are hereinafter expressly admitted.

#### IV.

This respondent has no knowledge or information, excepting the statements of the petitioner, concerning the matters or things, or any of them, set forth in the fifth, sixth, and seventh paragraphs of said petition, and, therefore, neither admits nor denies the same, but calls for strict proof thereof if the court shall rule that said matters and things are material and relevant to the determination of the matter in controversy in this suit; excepting this, that this respondent denies the allegations that the said orders, or either of said orders, or the regulation and classification of the accounts, or either of them, are unauthorized by statute, or that they, or either of them, will be a violation of the fifth article of the amendment to the Constitution of the United States or that said order will unlawfully deprive the petitioner of any property rights without due process of law.

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#### V.

This respondent admits that the allegations contained in the eighth paragraph of said petition are true, excepting as they are, or any one of them is, modified or controverted by facts hereinafter set forth in this answer.

#### VI.

This respondent has no knowledge or information—excepting the statements made to it by the petitioner, and as hereinafter stated in paragraph nine of this answer—concerning the matters and things, or any of them, set forth in the ninth paragraph of said petition, and therefore this respondent neither admits nor denies the same, but calls for strict proof thereof if the court shall rule that the said matters and things are material and relevant to the determination of the matters in controversy.

#### VII.

This respondent admits that the allegations contained in the tenth paragraph of said petition are true excepting as they are, or any of them is, modified or controverted by facts hereinafter set forth in this answer.

#### VIII.

Answering the eleventh paragraph of said petition this respondent admits that dividends upon its preferred capital stock should be paid out of current surplus earnings, but whether the petitioner is or will be able to pay such dividends if it complies with the just and lawful regulations made and promulgated by this

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respondent, this respondent has no knowledge, excepting the statements made to it by the petitioner, and therefore neither admits nor denies the same, but leaves the petitioner to make such proof concerning such matters as it may deem necessary and the court shall rule are material and relevant.

## IX.

Further answering said petition, this respondent says: That the said orders and each of them aforesaid, and the Classification of Expenditures for Additions and Betterments, and the General Balance Sheet Statement prescribed by this respondent as above set forth were each made under, and by virtue of, the provisions of section 20 of the act to regulate commerce as amended, and especially those portions thereof which provide that this respondent shall require annual reports from all common carriers subject to the provisions of said act and shall "prescribe the manner in which such reports shall be made" showing "the cost \* \* \* of the carrier's property" and "the amounts expended for improvements each year, how expended and the character of such improvements, \* \* \* the balances of profit and loss, and a complete exhibit of the financial operations of the carrier each year, including an annual balance sheet."

50 That "for the purpose of enabling it [respondent] the better to carry out the purposes of this act," it may "prescribe \* \* \* as near as may be a uniform system of accounts, and the manner in which such accounts shall be kept," for the purpose of acquiring, for the use of Congress and this respondent, truthful and accurate accounts and an annual balance sheet that will show among other things the true net cost of the road as actually operated at the time the return is made.

That the said orders, classification, and balance sheet, in so far as they affect the matter in controversy in this suit, do not undertake to determine or show the value of the railroad or railroad property for any purpose whatsoever, but they are intended to, and will when complied with, show and reflect the true cost of the railroad and railroad property in actual use by the company at any and all times; this information as to cost is specifically called for by said act to regulate commerce, and said orders, classification, and balance sheet were made and promulgated by this respondent to carry out the provisions of said act in this regard.

That in the case of the abandonment of railroad or property, not replaced in kind—that is to say, not replaced by a railroad serving the same territory and carrying like traffic—the cost of the abandoned road, less the salvage is to be credited to the property accounts and charged to Profit and Loss; this is on the ground that its earnings are presented in operations of past years; this disposition of

the charge operates to decrease the surplus earned during  
 50 the time the property was in use and casts the loss wholly upon the company. In the case of railroad or property abandoned and replaced in kind—that is to say, by new railroad

or property serving the same territory, traffic, or purpose—the [original]\* cost of replacing in kind.

(Amended by order of Jan. 25, 1912)

less the salvage, is to be credited to the property accounts and charged to operating expenses; provided that if the amount of the charge warrants a distribution of the loss over a series of years, the total amount may be charged into an account designated Property Abandoned Account, and from it distributed annually to the Operating Expense Account in such portions and during a term of years previously approved by this respondent; this method of charging out the loss of property abandoned and replaced in kind, is on the ground that such replacement has been made with a view to increase future revenues, or to decrease future operating expenses, or both, and such changes ultimately benefiting the public and the stockholder by securing a better or cheaper service.

The final results of this method of bookkeeping show (1) the entire transaction in proper detail, and (2) the correct net cost of the new line as operated after the additions and betterments have been made; (3) casts the burden of loss where it should properly be borne. A disposition of the charge by carrying it in property or capital account, as suggested in the petition, would improperly inflate that account by carrying in it the cost of property no longer in actual use.

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## X.

Further answering said petition, this respondent says that said Classification of Expenditures for Additions and Betterments, and particularly the portions thereof complained of in said petition, some time before the adoption and promulgation thereof as aforesaid, were submitted for criticism and suggestion to the Association of American Railway Accounting Officers, an association organized to consider and formulate a system of uniform accounts by common carriers operating steam roads subject to the act to regulate commerce; that said Kansas City Southern Railway Company, as this respondent is advised and believes, was at the time aforesaid a member of said association and was represented in said association by Mr. R. J. McCarty, vice president and auditor of the petitioner.

That said classifications were examined and considered by said association and conferences were had by and between the accounting officers of said association and this respondent relative to said classification, showing the cost of railroads and the disposition of the cost or value of abandoned roads or parts of roads or property; that the classification as promulgated by this respondent as aforesaid represents the consensus of opinion of the Association of American Railway Accounting Officers and this respondent regarding the just

[\* Word enclosed in brackets erased in copy.]

and proper disposition to be made of abandoned road and property. That said order and Classification of Expenditures for Additions and Betterments, adopted by this respondent on June 21, 1909, referred to herein and in said petition, became effective on July 1, 1909, and the same were, on and after the date aforesaid, public records of which the said petitioner had due notice, as provided by the act to regulate commerce; that the changes in petitioner's said railroad and railroad property, occasioning the abandonment of road and property as set forth in said petition, were undertaken, contracted for, and made by the petitioner after the making and promulgation of the order complained of and with full notice thereof.

That a system of transportation statistics, showing, among other things, the cost of all railroads operated in the United States subject to the act to regulate commerce—of great and inestimable value for information and comparison for the use of Congress, this respondent and the public—has been established through and by reports from all carriers subject to the act to regulate commerce, upon the basis and in compliance with said Classification of Expenditures for Additions and Betterments and the balance sheets made therefrom; that said accounting system is just and fair and reasonable to said carriers and said petitioner; that the integrity and value of said system of statistics would be greatly and irreparably injured and impaired by a cessation or suspension of said reports from said carriers. This respondent therefore has consistently, and without exception, refused to suspend, even temporarily, the operation and requirements of said orders as to any of the carriers aforesaid. And this respondent further says that said system of statistics would be greatly and irreparably injured at this time by the issuance of an injunction, temporary or permanent, by this court suspending, in whole or in part, the operation of said orders and classifications in respect to said petitioner herein.

All of which matters and things this respondent is ready to aver, maintain, and prove as this honorable court shall direct, and prays the same advantage as to each and all of the matters and things aforesaid as this respondent would be entitled to if the same were specially pleaded or set forth by way of demurrer.

And, having fully answered said petition, this respondent prays to be hence dismissed with its reasonable costs and charges in that behalf sustained.

INTERSTATE COMMERCE COMMISSION,  
By CHARLES W. NEEDHAM, *Solicitor*.

64-338 WASHINGTON,  
*District of Columbia, ss:*

I, James S. Harlan, a member of the Inter-state Commerce Commission respondent in the above-entitled cause, having read the foregoing answer and knowing the contents thereof, do hereby make oath that the matters and things therein stated are true to the best of my knowledge, information, and belief.

JAMES S. HARLAN.

Subscribed and sworn to before me, H. S. Milstead, a notary public in and for said District of Columbia, this 17th day of January, 1912.

[ NOTARIAL SEAL. ]

H. S. MILSTEAD,  
*Notary Public.*

\* \* \* \* \*

3339 *Order Granting Leave to Amend Answer of the Interstate Commerce Commission.*

(Entered January 25, 1912.)

In the United States Commerce Court.

No. 56.

KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,  
v.

UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervening Respondent.

And now, on this 25th day of January, 1912, comes the Interstate Commerce Commission, by Charles W. Needham, its Solicitor, and moves the Court for leave to amend its answer filed herein by striking out the word "original" at the beginning of the sixth line, page 8, and inserting after the word "cost" the following words of replacing in kind, and upon consideration thereof.

It is ordered that said motion be, and the same is hereby, granted, and that the word "original" at the beginning of line 6, page 8, in the answer of said respondent filed herein be stricken out, and that the words, of replacing in kind, be inserted after the word "cost" in said line.

MARTIN A. KNAPP,  
*Presiding Judge.*



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United States Commerce Court.

No. 56.

KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

vs.

UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE  
COMMISSION, Intervening Respondent.*Order Designating Judge Hunt to Hear Testimony.*

(Entered March 2, 1912.)

In said cause it is ordered that the Honorable William H. Hunt, Associate Judge of this Court, be and he is hereby designated to hear testimony and to rule upon the admissibility of evidence.

MARTIN A. KNAPP,

*Presiding Judge.*

March 2, 1912.

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United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

vs.

UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE  
COMMISSION, Intervener.*Order Designating Judge Carland to Hear Testimony.*

(Entered April 24, 1912.)

In said cause it is ordered that the Honorable John E. Carland, Associate Judge of this Court, be and he is hereby designated to hear testimony and to rule upon the admissibility of evidence.

It is further ordered that said cause be and it is hereby set down for the taking of testimony on May 6th and 7th, 1912, in the Court Room of the United States Commerce Court, Washington, D. C.

MARTIN A. KNAPP,

*Presiding Judge.*

April 24, 1912.

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In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY  
v.  
UNITED STATES AND INTERSTATE COMMERCE COMMISSION.

*Order.*

(Entered November 27, 1912.)

On motion of counsel for the Interstate Commerce Commission, due notice having been served and filed, it is now ordered that this cause be and the same is hereby set for the further taking of testimony before John E. Carland, one of the Judges of this Court, on Tuesday, December 10, 1912, at 10:30 o'clock A. M. at the court rooms, Southern Building, Washington, D. C.

It is further ordered that the clerk transmit forthwith a certified copy of this order to the counsel for the petitioner in the above-entitled cause.

MARTIN A. KNAPP,

*Presiding Judge.*

Washington, D. C., November 27, 1912.

(Certified copies sent to Samuel W. Moore and Samuel Untermyer Nov. 27, 1912.)

[Reporter's transcript of testimony, etc., printed in separate volume with index therein. — PRINTER.]

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In the United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Corporation,  
 Petitioner,  
 against  
 UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE  
 COMMISSION, Intervening Respondent.

*Stipulation as to Evidence.*

(Filed January 25, 1913.)

It is hereby stipulated by and between the parties to the above entitled cause that Bulletin No. 28 and Bulletin No. 33 of The Association of American Railway Accounting Officers may be made a part of the record of evidence offered in this case with the same force and effect as if the same had been offered in evidence by the Respondents and had been objected to by the Petitioner as irrelevant and immaterial and received by the Court subject to such objection; and that an appropriate order if necessary may be entered herein without further notice in order to effectuate the purpose of this stipulation; and that the said Bulletins subject to such objection may be printed in the record.

Dated, January 23, 1913.

SAMUEL UNTERMYER,

*Solicitor for Petitioner.*

WINFRED T. DENISON,

*Solicitor for United States of America, Respondent.*

CHAS. W. NEEDHAM,

*Solicitor for Interstate Commerce —,**Intervening Respondent.*

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United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Corporation,  
 Petitioner,  
 vs.,

UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE  
 COMMISSION, Intervener.

*Order.*

Entered May 20, 1913.

In the above entitled cause, an order having been entered allowing an appeal to the Supreme Court of the United States from the

final order or decree of the United States Commerce Court entered April 29, 1913, and the clerk having been directed to transmit to the Supreme Court a properly authenticated transcript of the record, proceedings and papers on which said order or decree was made and entered—

Now, pursuant to Section 2 of the Act of June 18, 1910, it is hereby ordered that the clerk shall transmit to the **Supreme Court** from the files of the Commerce Court the following original exhibits to the testimony taken before Judge Hunt, March 5, 1912, and before Judge Carland May 6, December 10, 11, 12, 13, 14 and 16, 1912, at Washington, which were not printed in full for the use of the Commerce Court:

Respondent's Exhibit C, being Bulletin No. 28, Association of American Railway Accounting Officers, Washington, D. C., June 17, 1907.

773 Respondent's Exhibit No. CC, being rough pencil sketch.

Petitioner's exhibit No. 3, being a certified copy of the Refunding and Improvement Mortgage of the Kansas City Southern Railway Company, dated July 1, 1909.

Petitioner's Exhibit No. 6, being a certified copy of a Report on the Proposed Revision of Grades and Alignment of the Main Line of the Kansas City Southern Railway etc., made by Horace G. Burt, June 1907.

Respondent's Exhibit Cal. No. 5, being Accounting Series, Circular No. 8, Interstate Commerce Commission, Division of Statistics and Accounts, April 10, 1907.

Respondent's Exhibit Cal. No. 8, being Accounting Series, Circular No. 11, Interstate Commerce Commission, Division of Statistics and Accounts, July 5, 1907.

Respondent's Exhibit Cal. No. 9, being Bulletin No. 33, Association of American Railway Accounting Officers, Washington, D. C., July 15, 1908.

Respondent's Exhibit Cal. No. 11, being Bulletin No. 36C, Association of American Railway Accounting Officers, Washington, D. C., April 19, 1909.

Respondent's Exhibit Cal. No. 12, being Bulletin No. 36D, Association of American Railway Accounting Officers, Washington, D. C., May 25, 1909.

By the Court.

MARTIN A. KNAPP,  
*Presiding Judge.*

May 20, 1913.

774-776

## RESPONDENT'S EXHIBIT C.

(Page 342 of Original Record.)

## Bulletin No. 28.

## Association of American Railway Accounting Officers.

Standing Committee on Corporate, Fiscal and General Accounts.  
 A. H. Plant, Chairman; M. Riebenack, R. A. White, M. P. Blauvelt, G. N. Wilson, G. E. Hustis, W. J. Hobbs, H. W. Walker, Chas. Haydon, W. N. D. Winne, C. I. Sturgis, C. F. Krebs, E. Young, Robert Toombs, R. L. Farrington, H. A. Gray, W. E. Bailey, S. B. Schuyler, S. C. Johnson, M. M. Kirkman, J. W. Renner, H. D. Bulkley, P. A. Hewitt, F. Noy, L. R. Stewart.

OFFICE OF THE CHAIRMAN.  
 WASHINGTON, D. C., June 17, 1907.

To Members of the Association of American Railway Accounting Officers,

GENTLEMEN: I beg to submit herewith the results of the deliberations of the standing committee on corporate, fiscal and general accounts at its meeting held at the Iroquois Hotel, Buffalo, N. Y., June 13 and 14, 1907.

1st. Extract from minutes of the meeting including organization of the Committee.

2d. Tentative Classification of Additions and Betterments Expenditures, including Text therefor.

It is understood by the committee that it is the purpose of the Interstate Commerce Commission not to promulgate through official order at this time the classification and Text for Additions and Betterments Expenditures, but that such classification and text will be submitted to individual lines by the commission, asking for suggestions and recommendations in respect thereto.

Respectfully submitted,

A. H. PLANT, *Chairman*.

P. S.—The notice of members is particularly called to the resolution adopted by the committee set forth on page 5, requiring prompt attention.

C. G. PHILLIPS, *Secretary*.

\* \* \* \* \*

777 The committee proceeded to the consideration of the tentative classification of additions and betterments.

The following preamble and resolution were adopted:

"Whereas, It is recognized by the standing committee on corporate, fiscal and general accounts of the Association of American Railway Accounting Officers that the matter of classification of additions and betterments expenditures includes matters of financial policies of

carriers, and that while the committee has formulated such classification and text therefor, it is felt that the whole subject should be submitted to the executive officers of lines members of the association; therefore

"Resolved, It is the sense of this standing committee that before this bulletin is submitted to the Interstate Commerce Commission that such members of the Association as desire to submit the same to their executive officers for any suggestions be permitted to do so, and have their answers to the chairman of this committee, Mr. A. H. Plant, comptroller, Southern Railway, Washington, D. C., before the 1st of July, 1907, and that the letters submitted to the chairman of this committee be transmitted to the Interstate Commerce Commission with the classification and text."

The tentative classification of additions and betterments expenditures and text therefor was adopted in the form attached hereto.

C. G. PHILLIPS, *Secretary*.

778-782 *Conclusions of Standing Committee on Corporate Fiscal and General Accounts on Tentative Classification of Additions and Betterments Expenditures and Text Therefor.*

NOTE.—The Classification of Construction and Equipment Expenditures applies exclusively to the construction and equipment of new main and branch lines.

\* \* \* \* \*

783 5. Grade Revisions and Changes of Line.

To this account should be charged:

Grade Revisions.—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment. The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels, and grading outfits, tool used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences, buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway crossing alarms and watch houses.

NOTE A.—The cost of such grading as is necessary to restore banks or cuts to original width, slope and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; relastasting, lining and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection; should all be charged to appropriate operating expense accounts.

NOTE B.—When, in reducing grades, grade crossings are eliminated and overhead crossings substituted therefor, the cost of grading

the highway or street approaches to the new crossings, the overhead bridge with its abutments, piers, and posts, should all be charged to account "Track elevation, elimination of grade crossings, etc." In case under crossings are substituted for grade crossings, the cost of the under crossing is a portion of the cost of the grade revision and should be charged to this account.

**Changes of Alignment.**—Cost of changing alignment for purposes of reducing curvature, cutting out bridges, tunnels, etc. The amount to be charged to this account for work of this description is the excess cost of the grading and bridging done, over the actual cost, or, if actual cost unknown, estimated original cost, of that portion of the grade, bridges, tunnels, etc., on the old line that will be abandoned or rendered unnecessary.

**NOTE.**—The explanations given under "grade revisions" as to the items constituting cost of grading, the portion of that cost and on the cost of track work of all kinds, chargeable to operating expense accounts, and changing the cost of new overhead crossings, apply equally to changes of alignment.

**Changes of Line.**—Cost of building new lines, exclusive of cost of right of way therefor, which should be charged to account "Right of way and station grounds," for the purpose of improving both grade and alignment, over the actual cost, if known, or estimated original cost, if actual cost unknown, of the line to be abandoned. It includes the cost of engineering; clearing and grubbing; grading, tunnels; bridges, trestles, and culverts; ties, rails, frogs, and switches, track fastenings, and other track material; ballast, track-laying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovels, and other work equipment, engines, cars, and crews employed in the work.

**NOTE A.**—Cost of buildings, water, and fuel stations and similar structures on new lines, should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate additions and betterments and operating expense accounts, as provided for in the various accounts herein relating to the different classes of buildings and structures.

The actual or estimated original cost, as the case may be, of the line to be abandoned, exclusive of right of way and station grounds and of buildings as above, with the cost of removal of tracks, bridges, etc., but less salvage, should be charged to the appropriate operating expense accounts.

**NOTE B.**—All expenditures charged to account "Grade revisions and changes of line" should be classed as "betterments."

## 792-803 20. Shops, Engine Houses and Turntables.

NOTE.—Expenditures charged to this account will be classed as "Additions" or "Betterments" according to the following definitions:

Additions.—To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); engine houses (including turntables, cinder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and outhouses in connection with additional buildings; additional oil houses, sand houses, storehouses for company's material, scrap bins, appurtenances, etc., also cinder pits, drop pits (outside of engine houses), and turntables where none before. This account should include amounts paid when erected by contract; labor and material when built by company; preparing grounds before and clearing same up after construction; foundations and painting; excavation for and lining of additional turntable pits, and of cinder or drop pits inside or outside of additional engine houses; foundation for additional turntables; loading, unloading and placing turntables in position; levers, tractors and stops for handling turntables; sewerage systems, connection with water supply system, and shop wells for additional buildings; architect's fees for drawing plans, for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses, and cost of all tracks laid in any additional building above described, on transfer and turntables in connection with such additional buildings and leading from such transfer or turntables into additional shops and engine houses.

When shop buildings, with their appurtenances, as above described, engine houses or turntables are removed and not replaced the original cost thereof, or, if original cost unknown, their estimated original cost, should be credited to this account and charged, less salvage, to the appropriate Operating Expense account, to which account should also be charged the cost of their removal and of restoring the grounds to proper condition, including filling foundations, wells, turntable pits, etc.

Betterments.—To this account should be charged the excess cost of new buildings to be used as shops, car sheds and engine houses, and of new transfer tables, turntables, cinder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for furnishing power or for heating and lighting existing shop buildings, engine houses, etc., when such plants not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, side walks and outhouses in connection with existing shop buildings or engine houses; excess cost of enlarging, altering or rebuilding oil houses, sand houses, storehouses for company's materials, scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing engine houses where no pits previously; tractors or

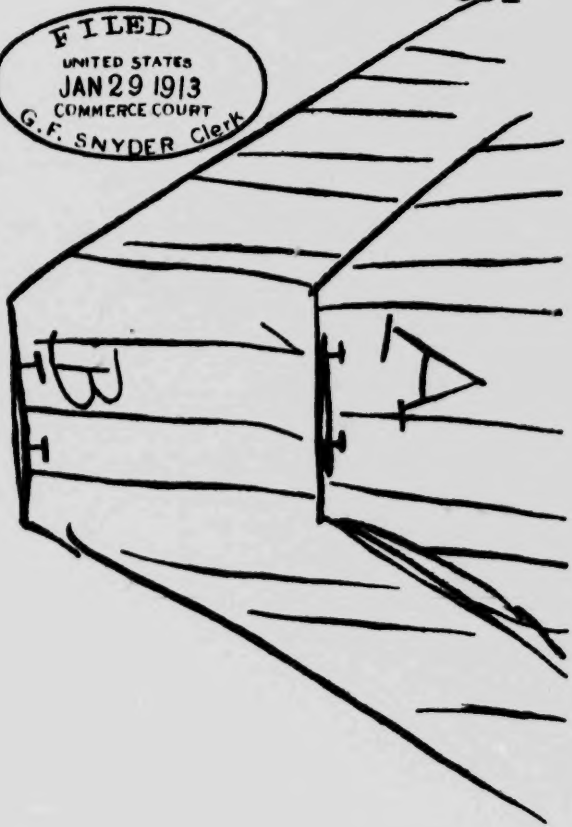


*Wm. H. Hink*

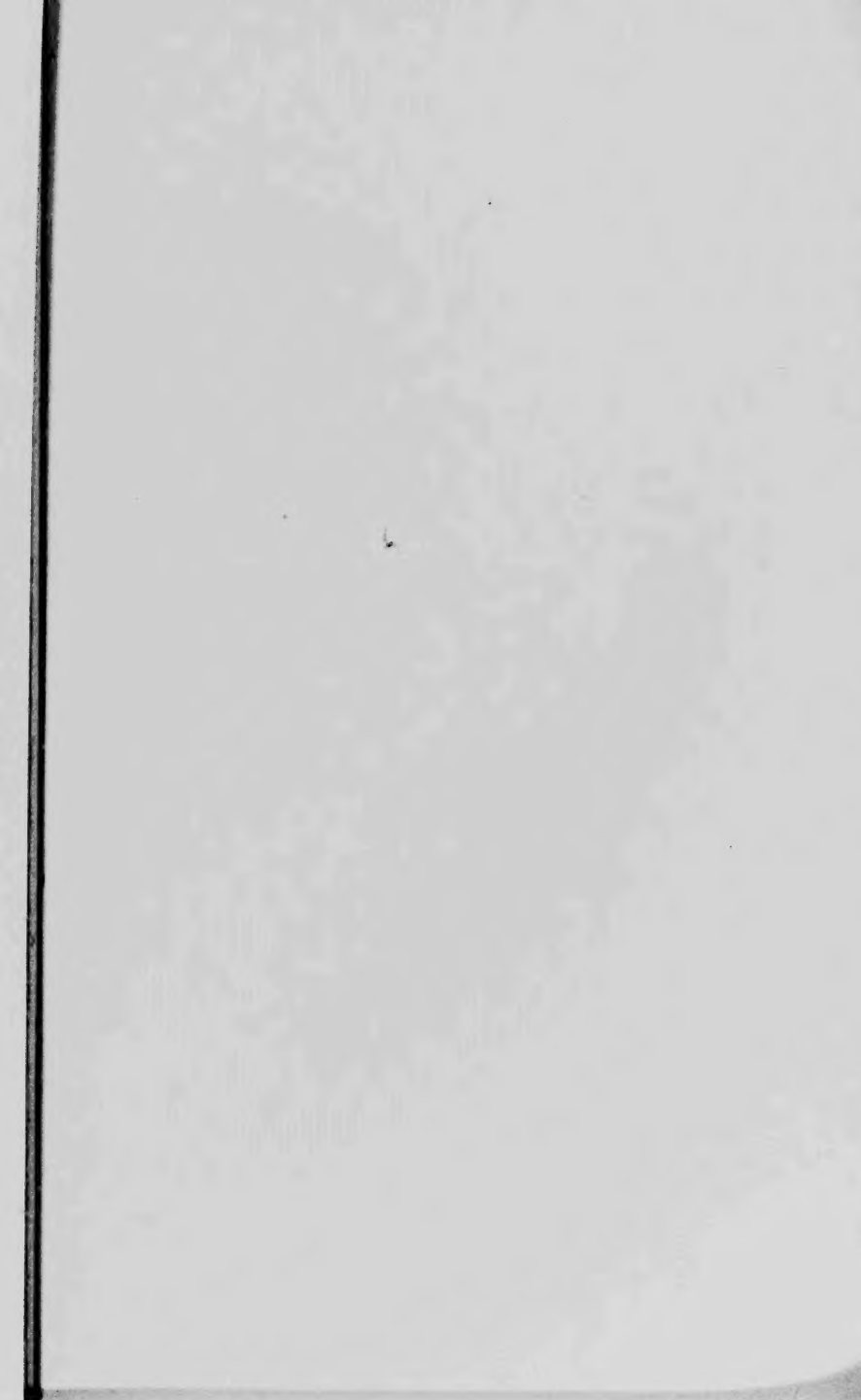
804

FILED  
UNITED STATES  
JAN 29 1913  
COMMERCE COURT  
G. F. SNYDER Clerk

56



*Perforated  
Exhibit Co.  
12/2/12*



other apparatus for handling existing turntables, enlarging and deepening shop wells; excess cost of reconstructing water supply and sewerage systems for shops and engine houses over cost of replacing the existing; cost of fences and hedges on or around existing shop grounds or buildings, where not previously fenced; all expenses incident to paving and draining existing shop grounds or grounds around existing shop buildings, engine houses, etc.; and excess cost of extending, rearranging or relaying tracks in shop buildings or engine houses, on transfer or turntables in connection therewith, or of tracks leading from such transfer or turntables into shop buildings or engine houses, over the cost of replacing the existing tracks.

\* \* \* \* \*

(Here follows diagram marked page 804.)

805

COMP'S EX. 3. J. R. W.

(P. 28 of Original Record of Testimony.)

29 A-3.

Filed Jan. 20, 1913. United States Commerce Court. G. F. Snyder,  
Clerk.

I, G. C. Hand, Secretary of The Kansas City Southern Railway Company, do hereby certify that the annexed is a true and correct copy of the said Company's Refunding and Improvement Mortgage, dated July 1, 1909, and of each and every part thereof.

[Corporate Seal The Kansas City Southern Railway Company. Incorporated March 19, 1909.]

G. C. HAND,

*Secretary The Kansas City Southern Railway Co.*

New York, March 2, 1912.

UNITED STATES OF AMERICA,

*City, County, and State of New York, ss:*

At New York, this second day of March, 1912, before me a Notary Public in and for the County of New York, personally appeared G. C. Hand, Secretary of The Kansas City Southern Railway Company, to me personally known and known to me to be the Secretary of The Kansas City Southern Railway Company and the person mentioned and described in and who acknowledged the foregoing certificate, and he duly acknowledged to me that he executed the same as Secretary of The Kansas City Southern Railway Company.

In witness whereof, I have hereunto affixed my name and notarial seal the day and year first above written.

[Seal Jesse Myers, Notary Public, New York County.]

JESSE MYERS,

*Notary Public, New York County, No. 144.*

My commission expires March 30th, 1913.

806

*Refunding and Improvement Mortgage.*

The Kansas City Southern Railway Company to The New York Trust Company and Edward F. Swinney, as Trustees.

Total Authorized Issue \$21,000,000.

807

An Indenture made and entered into as of the first day of July, in the year One thousand nine hundred and nine, by and between The Kansas City Southern Railway Company, a

corporation duly organized and existing under the laws of the State of Missouri (hereinafter called the Railway Company), party of the first part, and The New York Trust Company, a corporation duly organized and existing under the laws of the State of New York, and Edward F. Swinney, of Kansas City, Missouri (hereinafter called the Trustees), parties of the second part.

Whereas, the Railway Company is a corporation and body corporate existing under the laws of the State of Missouri, duly organized, and is the owner and lawfully in possession of the property, real, personal and mixed, railroads, franchises and easements hereinafter described, and is lawfully entitled to use, have, hold and enjoy the same, and is authorized to borrow money for its corporate purposes, in the manner herein set forth, and to mortgage its property and franchises to secure the payment of the moneys so borrowed, in the manner herein provided; and

Whereas, at a meeting of the Board of Directors of the Railway Company, duly called and held, it was duly resolved, subject to the approval and consent of the holders of the larger amount in value of the stock of the Railway Company, that the Railway Company issue the series of Refunding and Improvement Bonds herein described to the amount herein stated, to be secured by a mortgage upon the premises and after-acquired property and franchises of the Railway Company, such Bonds and mortgage securing the same to be in such form and to contain such covenants and conditions as might be approved by the Executive Committee of the Railway Company; and

Whereas, at a meeting of the stockholders of the Railway Company duly called and held pursuant to notice duly given according to law, proper resolutions were duly passed by stockholders holding the larger amount in value of the stock of the Railway Company authorizing and consenting to an increase of the bonded indebtedness of the Railway Company by issuing Twenty-one million dollars (\$21,000,000) par value of Refunding and Improvement Mortgage Gold Bonds, to mature April 1, 1950, and to be redeemable at any interest period upon sixty days' notice, at one hundred and five per cent. (105%) at the option of the Railway Company, each separate issue to bear interest at the rate of not exceeding five per centum per annum, payable semi-annually, as may be fixed from time to time by the Board of Directors and the Executive Committee of the Railway Company, the first issue to consist of Ten Million dollars (\$10,000,000.), face value, of bonds and to bear five per cent. interest, to be secured by a mortgage upon the present and after-acquired property and franchises of the Railway Company hereinafter described; and further authorizing and consenting that the bonds and mortgage securing the same should be in such form, and should contain such covenants and conditions as might be approved by the Executive Committee of the Railway Company; and

Whereas, the Railway Company by the action of its Board of Directors and the Executive Committee thereof, in the exercise of

their respective corporate powers and pursuant to such authorization and consent, for the purpose of improving the property and equipment of the Railway Company, have duly passed proper resolutions authorizing said series of bonds, the same to be issued from time to time within the terms of this Indenture and that the making and execution of this mortgage to secure the same, with all the covenants, conditions and provisions in this mortgage contained, the bonds to be substantially in the form of the bonds, coupon and registered in this mortgage set forth; and

Whereas, the forms of coupon and registered bonds and of the coupons attached to the coupon bonds and of the Trustee's certificate to be signed by the Trustee Company, so approved by the Board of Directors and Executive Committee of the Railway Company, are to be substantially in the following form, to wit:

809

[Form of Coupon Bond.]

No. —,

\$1,000.

UNITED STATES OF AMERICA.

*State of Missouri:*

*The Kansas City Southern Railway Company Refunding and Improvement Mortgage Gold Bond.*

The Kansas City Southern Railway Company, a corporation organized and existing under the laws of the State of Missouri, (hereinafter called the Railway Company), for value received, hereby promises to pay to bearer, or, if this bond be registered, to the registered holder hereof, One thousand dollars (\$1,000) in gold coin of the United States of America, of the present standard of weight and fineness, on the 1st day of April, 1950, at the Office of The New York Trust Company, herein termed Trustee Company, in the City of New York, and to pay interest thereon in like gold coin, at the rate of — per cent. per annum, payable semi-annually, at said office on the first day of — and the first day of — in each year, but the last installment shall become due and payable on the first day of April, 1950; such installments of interest to be paid upon presentation and surrender of the interest coupons hereto annexed as they respectively mature; both principal and interest being payable without deduction for any tax or taxes which the Railway Company may be required to pay thereon or to retain therefrom, by or under any present or future law or ordinance of the United States, or of any State, Territory, or Municipality therein.

This bond is one of a series of bonds, coupon and registered, of the aggregate principal sum of twenty-one million dollars (\$21,000,000), all issued and to be issued under and all equally secured by an Indenture of Mortgage, dated as of the first day of July, 1909, executed by said Railway Company to The New York Trust Company and Edward F. Swinney as Trustees, and all of like tenor and maturity except that different issues of said bonds may bear

10 Different rates of interest not exceeding five per centum per annum, and the interest may be payable at different semi-annual periods, but all issues bearing the same rates of interest shall have identical interest dates.

Reference is hereby made to the said Indenture of Mortgage for a description of the lands, railroads, corporate stocks, bonds and other securities and other present and after-acquired property and franchises of the Railway Company conveyed thereby, the nature and extent of the security, the terms and conditions upon which the said bonds are issued and secured, the rights of the Railway Company with respect to the redemption of said bonds, and the rights of the holders of said bonds under said Indenture.

Upon six months' default in the payment of interest on any of said bonds, the principal of this bond may become due in the manner and with the effect provided in said Indenture of Mortgage.

This bond may be redeemed at any interest period upon sixty days' prior published notice at 105 per cent. and accrued interest at the option of the Railway Company, in the manner and with the effect provided in said Indenture of Mortgage.

This bond shall pass by delivery unless registered as to principal in the owner's name upon the transfer books at the office of said Railway Company or its agency, in the City of New York, such registration being noted on the bond by the Railway Company in the manner and as provided by said Indenture of Mortgage securing the same. After such registration no transfer of this bond shall be valid unless made on said books by the registered owner, or his attorney, and similarly noted on the bond, but this bond may be discharged from registry by being transferred in like manner to bearer, after which transferability by delivery shall be restored and hereafter it shall continue subject to successive registrations and transfers to bearer as before; such registration, however, shall not affect the negotiability of the coupons, which shall continue to be transferable by delivery, notwithstanding the registration of this bond. The holder of this bond at his option may surrender the same with all unmatured coupons thereto appertaining for cancellation in exchange for a registered bond without coupons as provided in said Indenture of Mortgage securing this bond, and upon payment, if the Company require it, of the transfer charges therein provided.

11 This bond shall not become obligatory for any purpose until the certificate authenticating the same and hereon endorsed shall have been executed by the Trustee Company under the said Indenture of Mortgage.

No recourse shall be had, directly or indirectly, for the payment of any part of the principal or interest of this bond to the personal liability of any stockholder, officer or director, present or future, of the said Railway Company, whether by virtue of any statute, or by the enforcement of any assessment or penalty, or otherwise, all such liability being expressly waived and released by the acceptance of this bond.

In Witness Whereof, The Kansas City Southern Railway Com-

pany has caused this bond to be signed by its President, or one of its Vice-Presidents, and its corporate seal to be hereto affixed and attested by its Secretary, or an Assistant Secretary, and the coupons for said interest, authenticated by the engraved signature of its Treasurer, to be attached hereto as of the first day of July, 1909.

THE KANSAS CITY SOUTHERN  
RAILWAY COMPANY

By ———, *President*,

Attest

———, *Secretary*,

[*Form of Coupon.*]

§

On the 1st day of —, 19 —, The Kansas City Southern Railway Company, will pay to bearer, at the office of The New York Trust Company in the City of New York, — dollars, being six months' interest then due on its Refunding and Improvement Mortgage Gold Bond, No. —, unless previously redeemed, in accordance with the provisions of the Indenture of Mortgage therein referred to.

———, *Treasurer*.

(The coupon maturing April 1, 1950, shall be of like tenor except that it shall be for an amount equaling the interest from the due date of the last preceding maturing coupon.)

§12

[*Form of Registered Bond.*]

No. —,

§ —.

UNITED STATES OF AMERICA,

*State of Missouri:*

*The Kansas City Southern Railway Company Refunding and Improvement Mortgage Registered Gold Bond.*

The Kansas City Southern Railway Company, a corporation organized and existing under the laws of the State of Missouri (hereinafter called the Railway Company), for value received hereby promises to pay ———, or assigns, the sum of — Dollars (\$ —), in gold coin of the United States of America of the present standard of weight and fineness, on the first day of April, 1950, at the office of The New York Trust Company (herein termed Trustee Company), in the City of New York, and to pay the interest thereon at the rate of — per cent. per annum payable semi-annually at said office in like gold coin on the first day of —, and the first day of —, in each year but the last instalment shall become due and payable on the first day of April, 1950; both the principal and interest being payable without deduction for any tax or taxes which the Railway Company may be required to pay thereon or to retain therefrom under any present or future law or ordinance of the United States, or of any State, Territory or Municipality therein.

This bond is one of a series of bonds, coupon and registered, of the aggregate principal sum of Twenty-one million dollars (\$21,-



(\$100,000.00), all issued and to be issued under and all equally secured by an Indenture of Mortgage dated as of the first day of July, 1909, executed by said Railway Company to The New York Trust Company and Edward F. Swinney, as Trustees, and all of like tenor and maturity, except that different issues of said bonds may bear different rates of interest, not exceeding five per cent. per annum, and the interest may be payable at different semi-annual periods, but all issues bearing the same rates of interest shall have identical interest dates.

Reference is hereby made to the said Indenture of Mortgage for a description of the lands, railways, corporate stocks, bonds and other securities and other present and after-acquired property and franchises of the Railway Company conveyed thereby, the nature and extent of the security, the terms and conditions upon which the said bonds are issued and secured, the rights of the Railway Company with respect to the redemption of said bonds and the rights of the holders of said bonds under said Indenture.

Upon six months' default in the payment of the interest on any of said bonds, the principal of this bond may become due in the manner and with the effect provided in said Indenture of Mortgage.

This bond may be redeemed at any interest period, upon sixty days' prior published notice, at 105 per cent. and accrued interest, at the option of Railway Company, in the manner and with the effect provided in the said Indenture of Mortgage.

This bond is transferable by the registered holder hereof in person or by attorney duly authorized, on the books of the Railway Company at its office or agency in the City of New York, upon surrender and cancellation of this bond, and a new registered bond will be issued to the transferee in exchange herefor, as provided in said Indenture of Mortgage and upon payment, if the Company requires it, of the transfer charges therein provided.

This bond shall not be obligatory for any purpose until the certificate authenticating the same and hereon endorsed shall have been executed by the Trustee Company under the said Indenture of Mortgage.

No recourse shall be had, directly or indirectly, for the payment of any part of the principal or interest of this bond, to the personal liability of any stockholder, officer or director, present or future, of said Railway Company whether by virtue of any statute or by the enforcement of any assessment or penalty or otherwise, all such liability being expressly waived and released by the acceptance of this bond.

4 In witness whereof, The Kansas City Southern Railway Company has caused this bond to be signed by its President, one of its Vice-Presidents, and its corporate seal to be hereunto affixed, and attested by its Secretary or Assistant-Secretary, as of this day of —, 19—.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,

By —, *President*,

Attest:

—, *Secretary*.

## [Form of Trustee's Certificate.]

This is to certify that this bond is one of the series of bonds issued under the Indenture of Mortgage within referred to.

THE NEW YORK TRUST COM-  
PANY, *Trustee*,

By ———, *President*.

Whereas, in pursuance of said resolutions and of all and every legal power and authority in it vested, the Railway Company proposes now to make and execute, and from time to time hereafter to issue and to deliver the bonds hereby secured, and in this Indenture to declare the terms and conditions upon which every such bond is and shall be issued and secured; and

Whereas, all acts and things prescribed by law and the by-laws of the Railway Company, to make such bonds, when executed by the Railway Company and authenticated by the Trustee Company, the valid, binding and legal obligations of the Railway Company, and to constitute these presents a valid Indenture of Mortgage and pledge to provide for the authentication of said bonds and the enforcement of the payments of principal and interest thereon and of the covenants hereof, have been done and performed and have happened, and the execution and issue of said bonds, when authenticated, and the execution of this Indenture, have in all respects been dully authorized:

815 Now, therefore, this indenture witnesseth:

That the Railway Company in consideration of the premises, and of the sum of One dollar to it in hand paid by the Trustees, and in consideration of the purchase and acceptance of said Bonds by the holders thereof, and for other valuable considerations, the receipt whereof is hereby acknowledged, does hereby grant, bargain, sell, assign, convey and pledge unto the Trustees, their heirs, executors, administrators, successors and assigns, all the present and after-acquired premises, real and personal property, railroads, estates, appurtenances, rights, assets, bonds and shares of the capital stock of other companies, franchises and privileges of the Railway Company, and (save as hereinafter excepted), including among other properties the following:

1. All and singular the railroad of the Railway Company, formerly constructed, acquired, owned and operated by the Kansas City, Pittsburg and Gulf Railroad Company, or its receivers, and now owned and operated by the Railway Company herein as a part of its railway, commencing at or near Grand View, in the County of Jackson and State of Missouri, and thence extending in a southerly direction through the counties of Jackson, Cass, Bates, Vernon and Barton, in said State, to the west line of the State of Missouri, and thence through the Counties of Crawford and Cherokee, in Kansas, to the eastern line of the State of Kansas, and thence through the Counties of Jasper, Newton and McDonald, in the State of Missouri, to the southern line of said State of Missouri, thence through the County of Benton, in the State of Arkansas, to the

western line of said State; and thence through a portion of the State of Oklahoma, formerly Indian Territory, to the western line of said State of Arkansas, and thence in the County of Polk, in the State of Arkansas, to a point at or near Mena, in said County of Polk, in the State of Arkansas, where connection is made with the lines of the Texarkana and Fort Smith Railway Company; together with a branch line of railroad extending from Spiro, in the State of Oklahoma, formerly Indian Territory, to Fort Smith, in the State of Arkansas. Also, all the right, title, interest, estate, property and franchises of the Railway Company of, in and to \$16 any and all other railways, extensions or branches now owned, leased or held by the Railway Company, or in which it has any interest, wheresoever the same may be located in either of the States above named, or in any other state, territory or country, notwithstanding that the same may not be particularly herein set forth and described. Also, all the right, title, estate, interest and property of the Railway Company in any and all other lines of railway, extensions and branches hereafter acquired, held, owned or leased by the Railway Company, or in which it shall obtain or hold any interest, legal or equitable, whether the same be located in any of the states above mentioned, or in some other state, territory or country.

2. The railroad formerly belonging to the Kansas City Suburban Belt Railroad Company, and now owned and operated by the Railway Company as a part of its railway, including all and singular the double track, standard gauge railroad constructed from a point at the intersection of Second and Broadway Streets, in Kansas City, in Jackson County, Missouri; thence in an easterly direction, on and along said Second Street to its point of intersection with Harrison Street in said city; thence, in a northeasterly direction to a point near Randolph Avenue, in said city; thence east for a distance of about one and one-half miles; thence in a southeasterly and southerly direction to the southern limits of said city; thence in a general southwesterly direction to a point at or near the mouth of Brush Creek, in said Jackson County being about twelve (12) miles of standard gauge railroad, about five and fifty-seventh hundredths (5.57) miles of which are double tracked and all of which are now within the corporate limits of Kansas City; also all the lands, tenements, easements and hereditaments acquired or appropriated and which may hereafter be acquired or appropriated for the purpose of a right of way for said railroad, or for its side tracks and switches and terminal yards.

3. The railroad formerly belonging to the Consolidated Terminal Railway Company and now owned and operated by the Railway Company, as a part of its railway, including all and singular the standard gauge railroad constructed from a point on the line of The Kansas City Southern Railway, at or near the intersection of Walnut Street and Second Street in Kansas City, Jackson County, Missouri; thence in a generally westerly direction to a point on the state line between the State of Missouri and the State of Kansas, near the south bank of the Missouri River,

being about 1.45 miles of standard gauge railroad, and lying wholly within the said County of Jackson, State of Missouri, and wholly within the corporate limits of Kansas City; also all the lands, tenements, easements and hereditaments now acquired or appropriated or which may hereafter be acquired or appropriated for the purpose of a right of way for said railroad, or for its side tracks or switches and terminal yards.

4. The railroad formerly belonging to the Union Terminal Railroad Company and now owned and operated by the Railroad Company as a part of its railway, including all and singular the standard gauge railroad constructed, or which may be hereafter constructed, now built from a point in the City of Argentine, in the County of Wyandotte, in the State of Kansas, to a point on the north side of Kansas River opposite the said City of Argentine; thence in an easterly and northerly direction up and along the north side of the Kansas River to Ohio Avenue, Kansas City, Kansas; thence across said river and easterly to a connection with The Kansas City Southern Railway Company's railway at the state line between Missouri and Kansas, where the said railway intersects said state line on, or near the south bank of the Missouri River; the main line of the railway of The Union Terminal Railroad Company being about five and eighteen hundredths (5.18) miles in length and its side tracks and switches being about Ten and fifty-six hundredths (10.56) miles in length and all lying wholly within the county of Wyandotte and State of Kansas.

Also all the lands, tenements, easements and hereditaments now acquired or appropriated or which may hereafter be acquired or appropriated for the purpose of a right of way for said railroad, or for its side tracks or switches and terminal yards.

818 5. The railroad formerly belonging to the Kansas City and Independence Air Line and now owned and operated by the Railway Company as a part of its railway, including all and singular the standard gauge railroad of said Company constructed from a point on the line of The Kansas City Southern Railway, at or near the southeast corner of section twenty-five (25), Township fifty (50), range thirty-three (33) West in Jackson County, Missouri, thence in a general easterly direction to the city of Independence, in said County of Jackson, in the State of Missouri, being about five and six-tenths (5.6) miles of standard gauge railroad, and lying wholly within the said County of Jackson and State of Missouri, also all the lands, tenements, easements, hereditaments, acquired or appropriated or which may hereafter be acquired or appropriated for the purpose of a right of way for said railroad, or for its side tracks or switches or terminal yards.

6. Also the following described lots, tracts and parcels of land, situated in Kansas City, in the County of Jackson and State of Missouri, to wit:

The North fifty (50) feet of Lots numbered Ten (10) to fifteen (15) both inclusive, of King & Bouton's Resurvey of West half of Block Number Ten (10) of "Old Town of Kansas," as the same are marked and designated on the recorded plat of said resurvey.

now on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri; also,

All of Lots numbered one hundred and forty-one (41), [subject to the easement of the Kansas City, St. Louis and Chicago Railroad Company and Chicago and Alton Railroad Company over said Lot One hundred and forty-one (41)]; One hundred and forty-two (42), One hundred and forty-three (43), One hundred and forty-four (44); One hundred and forty-five (45) and One hundred and forty-six (46) in Block number Fourteen (14); also all of Lot One hundred and nineteen (119) (subject to the right of way of the Kansas City, St. Louis and Chicago Railroad Company), and all of Lots One hundred and seventeen (117), One hundred and eighteen (118), One hundred and twenty-one (121), One hundred and twenty-two (122), One hundred and twenty-three (123), One hundred and twenty-four (124),

819 and One hundred and twenty-five (125), in Block Number Twelve (12), also all of Lot numbered One hundred and Thirty-eight (138), in Block number Thirteen (13); also all of Lots numbered One hundred and twelve (112), One hundred and thirteen (113) and One hundred and fourteen (114), in Block number Eleven (11), all in the "Old Town of Kansas," now Kansas City, Missouri, as the same are marked and designated on the recorded plat of said Old Town, now on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri; also all of lots numbered Seven (7), Eight (8), Nine (9), Ten (10), Eleven (11), Twelve (12), Thirteen (13), Fourteen (14) and Fifteen (15), of King & Bouton's Resurvey of the East half of Block number eleven (11) of "Old Town of Kansas," now Kansas City, Missouri, as the same are marked and designated on the recorded plat of said resurvey now on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri.

Also all Lot numbered Twelve (12) in Block number Fifty-nine (59), all Lot numbered Four (4) and the West forty (40) feet of Lot numbered Five (5); and part of Lots numbered Seven (7), Eight (8), Nine (9), in Block number Eighty (80), all in East Kansas Addition in addition to the City of Kansas, now Kansas City, Missouri, as the same are shown upon the recorded plat of said Addition now on file in the office of the Recorder of Deeds in and for Jackson County, Missouri.

Also all Lots Eight (8), Nine (9), ten (10), Eleven (11), Twelve (12) and Thirteen (13), in Block One (1) of T. S. Case's subdivision of the East half of the Southwest quarter of the Northeast quarter of Section Twenty-seven (27), Township Fifty (50) North; Range Thirty-three (33) West as said subdivision is shown upon the recorded plat thereof, on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri.

All of block number four (4) in Centropolis an addition to Kansas City, Missouri, except Lots numbered One (1), Two (2), and Three (3).

All of Blocks numbered One (1), and Three (3), and a part of Block numbered Seven (7), in Coutes and Hopkins Addition, an addition to the City of Kansas, now Kansas City, Missouri, as the

same are shown upon the recorded plat of said addition, now  
 820 on file in the office of the Recorder of Deeds in and for Jackson County, Missouri.

All of Lots numbered Eleven (11) and Thirteen (13) of Block number Ten (10) and all of Lot numbered Nine (9) of Block number Twelve (12) of McCauley Park, an Addition to the City of Independence, Missouri, as per plat thereof on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri; also all of Lots numbered Twenty-eight (28), Twenty-nine (29), Thirty (30), Thirty-nine (39), Forty-one (41), Forty-two (42), Forty-three (43), Forty-four (44), Forty-five (45), Forty-six (46), Forty-seven (47), and Forty-eight (48), of Atkinson's Resurvey of Atkinson's First Addition to the City of Independence, Missouri, as the same appears upon the recorded plat of said resurvey on file in the office of the Recorder of Deeds in and for said Jackson County, Missouri. Also part of the South half of Lot numbered Twenty-seven (27) of the annexed part to the City of Independence, described as follows: "Beginning on Spring Street 99 feet and 4 inches from the Northwest corner of said South half of lot 27; running thence East 165 feet; thence South 99 feet and 4 inches; thence West 165 feet; thence North 99 feet and 4 inches to the point of beginning." Also all of Lot thirty-six (36) in Annexed part of the City of Independence, Missouri, as per the recorded plat thereof on file in the office of the Recorder of Deeds in and for Jackson County, Missouri. Also all of Lot numbered Fifteen (15) in Old Town, now City of Independence, Missouri, except Sixteen and one-half (16.5) feet off the South side of said Lot.

All that part of the N. W. quarter Section 6, Township 19 North, Range 33 W., Jackson County, Missouri, more particularly described as follows:

Beginning in the northerly extension of the east line of Armour Packing Company's Addition, at a point 7½ feet southerly from measured at right angles to the center line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur; Thence southerly along the northerly extension of the east line of Armour Packing Company's Addition to a point which is 21 feet southerly from, measured at right angles to, the center line of said Railway Company's  
 821 "High Line" spur; thence southeasterly parallel to and 21 feet southerly from said Railway Company's most southerly lead track to a point in the north line of Block 19 West Kansas Addition No. 1; thence east along the north line of said Block 19 and said north block line produced easterly to the east line of Wyoming Street or Wyoming Street produced north; thence south along said east line of Wyoming Street to a point 543.2 feet north of the north line of Ninth Street; thence east in a straight line to a point in the East line of the Farrier tract 200.5 feet north of the north line of Eighth Street produced; thence north along said east line of the Farrier tract to a point in the southerly right of way line of said Railway Company's "High Line" spur; thence westerly and northwesterly along said southerly right of way line to the point of beginning.

All of that part of the northwest quarter, Section 6, Township 19 north, Range 33 west, Jackson County, Missouri, more particularly described as follows:

Beginning in the northerly prolongation of the east line of Hickory Street at a point eight feet southerly from, measured at right angles to the center line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" Spur; thence southerly along the northerly extension of the east line of Hickory Street a distance of 88.6 feet to a point 6 feet northerly from measured at right angles to the center line of the Kansas City, Fort Scott and Memphis Railroad Company's most northerly switch track; thence westerly parallel to the center line of said switch track to a point in the northerly prolongation of the west line of Block 24, West Kansas Addition No. 1; thence north along the northerly extension of the west line of said Block 24, 146.6 feet, to a point 8 feet southerly from measured at right angles to the center line of said "High Line" spur; thence easterly parallel to the center line of said "High Line" spur to the place of beginning."

All that plot of Land beginning at the northeast corner of Block 16, in the "Extension of West Kansas Addition No. 1" an addition in Kansas City, Mo.; thence west along the north line of said Block 16 a distance of 72 feet; thence north along the north extension of the east line of Lot 13, in said Block 16, a distance of 32.56 feet to

s22 a point in the southerly right of way line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur; thence westerly along said southerly right of way line to a point in the northerly prolongation of the West line of lot 9 in said Block 16; thence southerly along said line and the West line of Lot 9 to a point 6 feet northerly from, measured at right angles to the center line of the Kansas City, Fort Scott & Memphis Railroad Company's most northerly switch track; thence easterly parallel to the center line of said switch track to a point in the east line of lot 13 in said Block 16, said point in the east line of lot 13 being 22 feet more or less, southerly from the northeast corner of said lot; thence east in a straight line to a point in the east line of lot 15, 18.9 feet south of the northeast corner of said lot; thence south along the east line of said lot 15 a distance of 0.85 feet; thence easterly 6 feet northerly from and parallel to the said northerly switch track to a point in the east line of said Block sixteen, 18.27 feet south of the northeast corner thereof; thence north along the east line of said Block 16 a distance of 18.27 feet to the point of beginning.

All that plot of Land beginning at a point in the northerly extension of the west line of Santa Fe street 295.4 feet north of the north line of Eighth Street; thence north along the northerly extension of the west line of Santa Fe Street to a point in the southerly right of way line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur; thence west along said southerly right of way line to a point in the northerly prolongation of the east line of Lot 8 in Block 15 of the "Extension of West Kansas Addition No. 1" an



Addition in Kansas City, Missouri; thence south along the northerly prolongation of the east line of said lot 8 to a point 6 feet northerly from, measured at right angles to the Kansas City, Fort Scott and Memphis Railroad Company's most northerly switch track; thence easterly parallel to and 6 feet northerly from the center line of said switch track to the place of beginning.

All that plot of Land beginning in a line 60 feet easterly from and parallel to the east line of Santa Fe Street at a point 10.5 feet north of the north line of Eighth Street, thence north along said line to a point in the southerly right of way line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur; thence northeasterly along said southerly right of way line to a point in the northerly prolongation of the west line of Block 7 in Coates and Hopkins Addition; thence south along said west line of Block 7 and the northerly prolongation thereof to the southwest corner of said Block 7; thence southwesterly along the prolongation of the south line of said block 7 to a point in the East line of Block 14 in "West Kansas Addition No. 1;" thence south along the East line of said Block 14 to a point 60.5 feet north of the north line of Eighth Street; thence along a straight line a southwesterly direction to the point of beginning.

The east one-half of lot 3 in block 5 in Lykins Addition to the City of Kansas (now Kansas City) Missouri, except a strip of ground through said lot 16 feet in width lying 8 feet on each side of the centre line of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur.

All of the south one-half of lot 29 Old Town, Kansas City, Missouri, except the following described tract of ground:

(1) Beginning at the northeast corner of Third Street and Broadway, thence north along the east line of Broadway a distance of 156.73 feet; thence east parallel to Third Street 57.5 feet; thence southerly to a point in the north line of Third Street 65 feet east of the point of beginning; thence west 65 feet to the point of beginning.

(2) The west 20 feet of lots 115 and 116 in Block 11 Old Town, Kansas City, Missouri.

(3) All of lots 1, 2, 3, 4, 5, and 6, in Campbell Block, Land No. 29 of Old Town, Kansas City, Missouri.

(4) Also all that portion of lots seven (7) and eight (8) in said Campbell Block, lying southerly of the following described line, to-wit: Beginning in the east line of said Lot 7 at a point 19.5 feet southerly from the northeast corner of said lot; thence west on a tangent and parallel to the north line of said lot seven feet to a point; thence on a curve to the left having a radius of 167.6 feet to a point in the south line of the west one-half of said Campbell Block.

(5) Also an individual one-half interest in that part of lots 9 and 10 in said Block lying east of said described curved line.

824 Also tract of land described as follows:

Beginning at a point in the north line of lot 101, Block



10, Old Town, Kansas City, Missouri, 80 feet east of the northwest corner thereof, thence west along the south line of Second Street 80 feet to the Northwest corner of said lot 101; thence South along the East Line of the North and South alley in said block 10 a distance of 50 feet; thence northeasterly in a straight line to the point of beginning.

That part of lots 27 and 30 in Block 3, Old Town, Kansas City, Missouri, described as follows:

Beginning at the southwest corner of said lot 30; thence in a northerly direction along the east line of Main Street a distance of 92 feet; thence in a southeasterly direction on a line forming an angle of 62 degrees 57 minutes with the east line of Main Street a distance of 159.5 feet to a point in the east line of said lot 30; thence southerly along the east line of said lot 30 a distance of 19.5 feet to the southeast corner of said lot 30; thence west along the north line of Second Street a distance of 142 feet to the place of the beginning subject to the right of way of The Kansas City Southern Railway Company's (formerly the Consolidated Terminal Railway Company's) "High Line" spur.

All that part of lot 33 of Hurek's Subdivision of Guinotte Farm lying north of the Kansas City Suburban Belt Railroad Company's right of way.

Also all that part of the west one-half of lot 34 of Hurek's subdivision of Guinotte Farm lying north of the Kansas City Suburban Belt Railroad Company's right of way.

Also tract of land described as follows:

(1) Beginning at a point in the east line of the southeast quarter, northeast quarter Section 27, Township 50 north, Range 33 west, Jackson County, Missouri, where the Kansas City Suburban Belt Railroad Company's northerly right of way line intersects said line; thence northerly along said east section line a distance of 200 feet; thence westerly parallel to said northerly right of way line a distance of 1,320 feet to the west line of said southeast quarter, northeast quarter Section 27; thence south along said west quarter section line a distance of 200 feet; thence east along said north right of way line 1,320 feet to the point of beginning.

(2) Beginning at a point in the west line of Section 26, Township 50 north, Range 33 west, where the Kansas City Suburban Belt Railroad Company's north right of way line intersects said section line; thence north along said Section line 200 feet; thence east parallel to the said north right of way line a distance of 1,970 feet; thence south at right angles to last described course a distance of 200 feet to a point in said north right of way line; thence west along said right of way line 1,970 feet to the point of beginning.

Also tract of land described as follows:

(1) A strip of land in Section 25, Township 50 north, Range 33 west, 250 feet in width lying on the west and south side of and immediately adjacent to the right of way of the Kansas City Suburban Belt Railroad Company extending from the north line of the right of way of the Missouri Pacific Railway Company in a northwesterly direction, parallel to and adjoining the right of way of the Kansas

City Suburban Belt Railroad Company, a distance of 3,086 feet, measured along the center line of said strip.

(2) Also a strip of land 250 feet wide on the south side of the right of way of said Kansas City Suburban Belt Railroad Company, extending from the west end of the strip of land above described in a northwesterly direction along and adjoining the right of way of said Kansas City Suburban Belt Railroad Company, a distance of 1723.8 feet measured on the center line of said strip; said two tracts containing 28 acres, excepting;—however from these two tracts the following:

Beginning at a point in the south line of The Kansas City Southern Railway Company's (formerly the Kansas City Suburban Belt Railroad Company's) right of way line, 40 feet measured at right angles from the original station 252 + 88.9, said station point being 3944.9 feet easterly measured along said Railway Company's right of way from the C. M. & St. P. Ry. Co.'s main track; thence southerly continuing on said right angle line 47.85 feet to a rail monument, 73.2 feet on line forming an angle of 89 degrees 07 minutes with said right angle line from the southeast corner of the main building of the Sun Elevator; thence westerly on a line forming an angle of 92 degrees 12 minutes with said right angle line 252 feet to rail monument; (said last mentioned line being parallel to and

4 feet distant from the southern line of the main building of 826 said Elevator); thence northerly on a line forming a north-east angle of 90 degrees 50 minutes with said last mentioned line 49.7 feet to a point in said Railway Company's south right of way line; thence easterly along said line 255 feet to a point of beginning.

(b) Beginning at a rail monument in the south line of said 28 acre tract 2.55 feet westerly from the stone foundation of the Exchange Elevator annex; thence northerly at right angles to said line 13.45 feet; thence easterly on a line forming an interior angle of 90 degrees 10 minutes with said last mentioned line, and 1.4 feet from the shed annex to said elevators 115.4 to a rail monument; thence southerly on a line forming an interior angle of 89 degrees 50 minutes with last mentioned course 13.8 feet to a point in a line of said 28 acre tract; thence westerly along same 115.4 feet to place of beginning.

(3) Also the following described lands:

Beginning at the southwest corner of the northwest quarter section 25, Township 50 north, Range 33 West, Jackson County, Missouri; thence east along the south line of the northwest quarter of said Section 25, 1631.25 feet to a point 100 feet southwest of (measured at right angles) to the southerly boundary line of above described land owned by The Kansas City Southern Railway Company (formerly the Kansas City Suburban Belt Railroad Company); thence in a southeasterly direction, along a line parallel to and 100 feet from said southerly line of said The Kansas City Southern Railway Company's land 2,147.65 feet to a point which is 981.23 feet east and 431.72 feet north of the southwest corner of the northwest quarter, southeast quarter of said section 25; thence in a southeast-

erly direction along a straight line 576.9 feet to a point in the westerly line of the land above described, which point is 1,416.30 feet east and 90.35 feet north of the southwest corner of the northeast quarter, southeast quarter of said section 25; thence in a northwesterly direction along the southerly line of said The Kansas City Southern Railway Company's land as above described, to a point 163.5 feet east of the west line of the northwest quarter of said Section 25; thence in a southwesterly direction 150.95 feet to a point 598.35 feet north and 14.64 feet east of the southwest corner of the northwest quarter of said section 25; thence west 14.64 feet to a point in the west line of said section 25; thence south on said west line 598.35 feet to the point of beginning.

27 (4) Beginning at the southeast corner of the northeast quarter Section 26, Township 50 north, Range 33 West, Jackson County, Missouri; thence north along the east line of said northeast quarter 595.35 feet to a point 25 feet south of the south line of The Kansas City Southern Railway Company's (formerly the Kansas City Suburban Belt Railroad Company's) main line right of way; thence west along a line 25 feet southerly from and parallel to the said southerly right of way line 206.55 feet to a point; thence south 75 feet; thence west 150 feet; thence north 75 feet; thence west along a line 25 feet southerly from and parallel to said southerly right of way line 221.2 feet; thence northwesterly 150.95 feet to a point in said southerly right of way line; thence west along said southerly right of way line to a point which is 370 feet east of the C. M. & St. P. Railway's easterly right of way line, (said 370 feet being measured along said The Kansas City Southern Railway Company's southerly right of way line); and said point being 704.87 feet west of the east line of the northeast quarter of said Section 26; thence in a southeasterly direction along a line which makes an angle of 57 degrees 30' 50" with said The Kansas City Southern Railway Company's southerly right of way line, a distance of 737.41 feet to a point in the south line of the northeast quarter of said Section 26, said point being 275 feet east of the C. M. & St. P. Railway's easterly right of way line, measured along the south line of the northeast quarter of said Section 26; thence east along the south line of said northeast quarter of Section 26 a distance of 1308.72 feet to the place of beginning.

Also, the following described tract of land:

Beginning at a point 775.58 feet west and 20 feet north of the southeast corner of Section 28, township 50 north, Range 33 west; thence west along the north line of Rochester Avenue a distance of 100 feet to a point; thence north along a line parallel to the west line of Scott Avenue 120 feet; thence east along a line parallel to the north line of Rochester Avenue a distance of 100 feet; thence south 20 feet to the point of beginning. All being a portion of the "Subdivision of Guinotte Lands" in Kansas City, Missouri.

7. All the roadbeds, rights of way, station and terminal grounds, railroad and other yards, and lands and buildings now held by the Railway Company, or hereafter acquired by it or its successors, and appertaining to or provided for use in con-

nection with any of said railways or railroads; also, all tracks, side tracks, second-tracks and branches and bridges, viaducts, docks, culverts, fences, ditches, stations, elevators, engine houses, car houses, coal houses, wood houses, machine shops, telegraph and telephone lines, superstructures, rails, switches, ties, iron, chains, bolts, turntables, gravel pits, and all structures now held by the Railway Company, or hereafter acquired by it, or its successors, and appertaining to any of said railways or railroads; also any and all equipment, machinery, instruments, tools, implements, materials, furniture and other chattels; also, all wood, coal, oil, fuel and other supplies, and all engines, locomotives, tenders, cars and other rolling stock, equipment and furniture of every kind and description now held by the Railway Company or hereafter acquired by it or its successors, and appertaining to or provided for use upon any of said railways or railroads; also, any and all liens, leases, terms, contracts, and all books of account, maps, inventories and other documents, and also all other property and interests legal or equitable, real, personal or mixed of every kind and description, save as hereinafter stated, now owned or hereafter acquired in any wise or at any time, belonging or appertaining to the railroads above described, or to any other lines of railway, extensions or branches now owned or hereafter acquired by the Railway Company; also, any and all rights, privileges, franchises and immunities which the Railway Company now has or shall hereafter acquire, have or possess in respect to the railroad above described, or any other lines of railway, extensions or branches or other property now owned or hereafter acquired or appertaining to the use, operation or enjoyment thereof; together with the rents, issues, profits, tolls and other benefits and advantages of, or in any way growing out of, all or any of said railroads, railways, property and franchises now owned or hereafter acquired. Also, all and singular the tenements, hereditaments and appurtenances to the said premises belonging, the reversion or reversions, remainder or remainders, and all the estate, right title, interest, property, claim, possession and demand whatsoever, as well in law as in equity, which the Railway Company now has, or which it or its successors may hereafter acquire in, to or of the same, and every part thereof.

829 8. Any and all property, interests and things of value of any kind, name or nature, legal or equitable, real, personal or mixed, including stocks, bonds, claims or indebtedness which from time to time hereafter may be conveyed and mortgaged, or pledged and delivered, or by writing of any kind assigned or transferred by the Railway Company, or by any one in its behalf, to the Trustees, who are hereby authorized at any and all times to receive any property, as and for additional security, and also, as hereinafter provided, as substituted security for the bonds issued, or to be issued hereunder, and to hold and apply any and all such property subject to the terms hereof.

9. A. Also the following described stocks and bonds, all of which are deposited with The Mercantile Trust Company subject to the pledge and hypothecation of the First Mortgage and Deed of Trust

of the Railway Company to The Mercantile Trust Company and Selwyn C. Edgar, Trustees.

(a) One thousand nine hundred and ninety-one (1,991) shares (being the entire issue thereof, except nine (9) shares owned by the directors of the Company) of the capital stock of The Texarkana and Fort Smith Railway Company, a corporation organized under the laws of the State of Texas, of the par value of Fifty dollars (\$50) each; and Five thousand, five hundred and ninety-one (5,591) mortgage bonds (being the entire issue thereof), of said The Texarkana and Fort Smith Railway Company for the sum of One thousand dollars (\$1,000) each;

(b) Two thousand nine hundred and fifty (2,950) shares (being the entire issue thereof, except fifty (50) shares owned by the directors of the Company,) of the capital stock of The Kansas City, Shreveport and Gulf Railway Company, a corporation organized under the laws of the State of Louisiana, of the par value of One hundred dollars (\$100) each; and Six thousand six hundred and twenty-three (6,623) mortgage bonds (being the entire issue thereof) of said The Kansas City, Shreveport & Gulf Railway Company for the sum of One thousand dollars (\$1,000) each; said The Kansas City, Shreveport and Gulf Railway Company and said The Texarkana and Fort Smith Railway Company owning and operating lines of railroad extending from Meina in the County of Polk,

830 in the State of Arkansas, in a generally southerly direction through the Counties of Polk, Sevier, Little River, and Miller, in the State of Arkansas; and the Counties of Bowie, and Cass, in the State of Texas, and the Parishes of Caddo, De Soto, Sabine, Vernon and Calcasieu, in the State of Louisiana; and the Counties of Newton, Orange and Jefferson, in the State of Texas, to Port Arthur, in said last named State; with branches extending from De Quincy, in the State of Louisiana, to Lake Charles in the same State;

(c) One thousand, five hundred (1,500) shares (being the entire issue thereof) of the capital stock of The Kansas City, Shreveport and Gulf Terminal Company, a corporation organized under the laws of the State of Louisiana, of the par value of One hundred dollars (\$100) each;

(d) Ten thousand (10,000) shares of the capital stock of The Port Arthur Canal & Dock Company, a corporation, organized under the Laws of the State of Texas, of the par value of One hundred dollars (\$100) each (being the entire issue thereof), and one bond for One million dollars (\$1,000,000), being the entire amount of bonds outstanding of said The Port Arthur Canal & Dock Company; together with any and all stocks and bonds issued by the said last mentioned Company, or any interest therein which may be hereafter acquired, owned or controlled by the Railway Company.

B. Also the following described stocks and bonds, which are to be delivered to the Trustee Company concurrently with the execution of these presents.

(e) Six thousand five hundred (6,500) shares of the capital stock of The Arkansas Western Railway Company, a corporation organized under the laws of the State of Arkansas, of the par value of One

hundred dollars (\$100) each, being the entire issue thereof. The Six hundred and fifty (650) bonds for One thousand dollars (\$1,000) each, issued by the said The Arkansas Western Railway Company, being the entire issue thereof, and belonging to the Railway Company, are not covered by this Indenture.

(f) Three hundred shares of the capital stock of the Maywood & Sugar Creek Railway Company of the par value of One Hundred dollars (\$100) each, being the entire issue thereof:

(g) Eight hundred and five (805) shares of the capital stock of the Mena and Eastern Arkansas Railroad Company, of the par value of One hundred dollars (\$100) each.

831 To have and to hold the premises, railroads, property, real and personal, rights, privileges, franchises, estates, bonds, stocks, assets and appurtenances hereby granted, conveyed, assigned and pledged, or intended to be granted, assigned or pledged, unto the Trustees, and their heirs, executors, administrators, successors and assigns forever.

Subject, nevertheless, to the Mortgage or Deed of Trust made by the Railway Company to The Mercantile Trust Company and Selwyn C. Edgar, Trustees, dated April 2, 1900, to secure the payment of bonds for the aggregate principal sum of Thirty million dollars (\$30,000,000), payable April 1, 1950, bearing interest at the rate of three per cent. per annum, payable semi-annually, and a supplemental mortgage made by the Railway Company to said Trustees, dated January 15, 1902, specifically subjecting certain after acquired properties to the lien of said mortgage of April 2, 1900; and subject, also, as to certain portions of the equipment and rolling stock hereinbefore described, to the terms of certain outstanding equipment agreements dated November 1st, 1905, and June 1, 1906, executed by Blair & Company, The Kansas City Southern Railway Company, and The New York Trust Company, Trustee; and subject also as to other portions of such equipment and rolling stock to an agreement dated January 1st, 1908, executed by The Kansas City Southern Railway Co. and The Equitable Trust Co. of New York.

The aforesaid grant, conveyance and pledge is in trust nevertheless for the equal and proportionate benefit and security of all the holders of the bonds issued or to be issued hereunder and the interest to become due thereon as the same shall accrue without preference or priority of any of said bonds over any other of said bonds, on account of the time of their issue, or otherwise, and for enforcing the payment of the principal and interest of the said bonds according to their tenor, with the powers and authority, and subject to the agreements, covenants and conditions hereinafter expressed of and concerning the same, namely:

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## Article First.

### Concerning the Bonds.

1. The bonds issued under and secured by this Indenture (hereinafter referred to as Refunding and Improvement Bonds) shall be issued substantially in the forms hereinbefore set forth, and shall be

known as "Refunding and Improvement Mortgage Gold Bonds." The coupon bonds shall be dated as of the first day of July, 1909, and shall be for the principal sum of One thousand dollars (\$1,000) each, and shall be payable the first day of April, 1950, in gold coin of the United States, of the present standard of weight and fineness, and shall be numbered consecutively M1 and upwards. The coupons shall be payable in like gold coin semi-annually, except that the coupon representing the instalment of interest to become due on the first day of April, 1950, shall cover the period from the date of maturity of the last preceding coupon; said payments of both principal or interest for any tax or taxes which the Railway Company may be required to pay thereon or to retain therefrom by or under any present or future law or ordinance of the United States of America or of any State, Territory or Municipality therein.

2. The coupon bonds shall pass by delivery unless registered as principal in the owner's name upon the transfer books at the office of the Railway Company or its agency in the City of New York, such registration being noted on such bonds by the Railway Company. After such registration no transfer of bonds so registered shall be valid unless made on the books by the registered owner or his attorney, and similarly noted on the bonds, but such bonds may be discharged from registry by being transferred in like manner to bearer, after which transferability by delivery shall be restored and hereafter they shall continue subject to successive registrations and transfers to bearer as before; such registration, however, shall not affect the negotiability of the coupons, which shall continue to be transferable by delivery notwithstanding the registration of the bonds to which they are annexed.

3. The Railway Company shall keep and covenants that it will keep while and so long as any of the Refunding and Improvement Bonds shall be outstanding, at its office in the Borough of Manhattan, in the City and State of New York, or cause — to be kept at some bank or trust company as its agent in said Borough, books for the registration and transfer of bonds issued hereunder, which, at all reasonable times, shall be open for inspection by the trustees or by any holder of bonds issued hereunder; and, upon presentation for such purpose the Railway Company will register, or cause to be registered in such transfer books, as herein provided, and under such reasonable regulations as it may prescribe, any bond issued under the provisions hereof.

All the bonds shall be issued originally as coupon bonds. The holder of any coupon bond or bonds secured hereby may at any time surrender the same with all unmatured coupons thereto belonging and thereupon the Railway Company shall issue and the Trustee Company shall authenticate and deliver in exchange for each coupon bond or bonds a like amount of registered bonds, without coupons bearing interest at the same rate from the last preceding interest day and which shall have endorsed thereon the serial number or numbers borne by the coupon bond or bonds in exchange for which the said registered bond or bonds shall have been issued. In every case of such exchange the Trustee Company

forthwith shall cancel the surrendered bond or bonds and coupons and upon demand shall deliver the same to the Railway Company. The registered bonds shall be transferable on the books of the Railway Company by the registered owner or his duly authorized attorney and whenever any registered bond shall be so surrendered for transfer, the Railway Company shall issue, and the Trustee Company shall authenticate and deliver, upon surrender and cancellation of the registered bond or bonds transferred, a like principal amount of new registered bonds bearing interest at the same rate from the last preceding interest day, and which shall have endorsed thereon the same serial number or numbers of the coupon bonds which were endorsed upon the registered bond or bonds so surrendered and cancelled.

For any exchange of coupon bonds for registered bonds, and for any transfer of registered bonds, the Railway Company, at its option, may require the payment of a sum sufficient to reimburse  
 834 it for any stamp tax or other governmental charge connected therewith and also of the further sum of not exceeding one dollar for each new bond issued upon transfer or exchange.

The registered bonds shall be of the denomination of \$1,000 or \$5,000 and of such multiples of \$5,000 as the Board of Directors or Executive Committee of the Railway Company shall authorize from time to time. The registered bonds shall bear the date of the time of their issue, and interest shall be payable thereon at the same dates on which the coupons appertaining to the bonds represented thereby were payable. Every registered bond shall bear thereon an endorsement in substantially the following form, namely:

[Registered Bonds of the Denomination of \$1,000.]

"The within bond is issued in lieu of or in exchange for a Coupon Bond numbered —, for \$1,000, which bond is not contemporaneously outstanding."

[Registered Bonds of the Denomination of \$5,000, or Multiples of the Latter.]

"The within bond is issued in lieu of or in exchange for Coupon Bonds numbered —, for \$1,000 each, none of which bonds are contemporaneously outstanding."

4. Each of said bonds shall be authenticated on behalf of the Trustee Company by the signature of its President or one of its Vice-Presidents to the certificate thereon endorsed as one of the series of bonds mentioned in this Mortgage therein referred to. Only such bonds as shall be so authenticated by the Trustee Company shall be entitled to the rights, lien or security hereby afforded, and such authentication upon any bond executed by the Railway Company shall be conclusive evidence in favor of any and every holder or registered owner thereof in good faith that the bond so



authenticated has been duly issued hereunder, and is entitled to the benefit of the trust hereby created equally with all other outstanding bonds so issued and authenticated. The bonds shall be executed on behalf of the Railway Company by its President or one of its Vice-Presidents, and its corporate seal shall be thereunto affixed and attested by its Secretary or an Assistant Secretary, and the coupons shall be authenticated by the engraved signature of the present or any future Treasurer of the Railway Company. In case the officers who shall have signed or sealed any of said bonds shall cease to be such officers of the Railway Company before the bonds so signed and sealed shall have been actually authenticated by the Trustee Company, or delivered, or sold, such bonds and the signatures thereto may, nevertheless, be adopted by the Railway Company, and upon the written request of the Railway Company shall be authenticated by the Trustee Company and delivered, subject to the provisions of this Article hereof, and may be sold by the Railway Company as though the persons who signed or sealed such bonds had not ceased to be such officers of the Railway Company. Before delivering any of the Refunding and Improvement Bonds as hereinafter provided the Trustee Company shall cut off and cancel all coupons thereto belonging which may have heretofore matured, and shall upon written request deliver the same to the Railway Company.

5. The aggregate principal sum of all the Refunding and Improvement Bonds at any time or times issued and outstanding under or intended to be secured by this Indenture shall not exceed twenty-one million dollars (\$21,000,000). The said bonds shall be made to bear interest at such rate not exceeding Five per cent, (5%) per annum as shall have been fixed therefor by the Board of Directors or the Executive Committee of the Railway Company and as shall be designated in said bonds when issued; and different issues of such bonds may bear different rates of interest, and the interest thereon respectively may be payable at different semi-annual periods; but all issues bearing the same rate of interest shall have identical interest dates. All the bonds issued hereunder shall from time to time be executed on behalf of the Railway Company in the manner hereinbefore provided, and shall then be delivered to the Trustee Company for authentication by it and the Trustee Company shall thereupon authenticate and deliver such bonds to the Railway Company or upon its order as follows:

6. (a) Ten million dollars (\$10,000,000) face value of said bonds bearing interest at the rate of five per centum per annum shall be delivered to the Trustee Company accompanied by a certified copy of a resolution of the Board of Directors or the Executive Committee of the Railway Company directing the Trustee Company to authenticate and deliver to the Railway Company, or its order, all of said Ten Million dollars (\$10,000,000) of bonds and with the Trustee Company shall authenticate and deliver said bonds as directed. The Railway Company covenants to use the bonds so delivered to it and the proceeds thereof in calling in and redeeming and cancelling its Five million one hundred thousand

(85,100,000) Collateral Gold Notes issued April 2, 1906, and for the general improvement of its property.

The Trustee Company may authenticate and deliver said Ten million dollars (\$10,000,000) of bonds, or any portion thereof, prior to the record of this Indenture.

(b) The remaining Eleven million dollars (\$11,000,000) face value of bonds may be issued from time to time subsequent to July 1, 1910, in such amounts and at such rates of interest not exceeding five per centum per annum as may be authorized by the Board of Directors or the Executive Committee of the Railway Company for one or more of the following purposes:

To develop the territory served by the mortgagor by the construction or acquisition of short branch lines.

The construction of additional main track required in double tracking any of the lines of railroad then subject to this Indenture.

The construction of tunnels and bridges and the reduction of grades or change of line upon any of the lines of railroad then subject to this Indenture.

The purchase of rolling stock and other equipment for use upon any of the lines of railroad then subject to this Indenture.

The purchase and improvement of additional real estate for use in connection with the operation or maintenance of any of the lines of railroad then subject to this Indenture; the construction, purchase or acquisition of terminals, stations, yards, sidings, industrial tracks, shops, depots, warehouses and other structures which shall be required or be useful or convenient in the operation or maintenance of any of the lines of railroad then subject to this Indenture; and the construction or purchase of other additions to and improvements and betterments of and upon any of the lines of railroad then subject to this Indenture.

(c) Whenever, subsequent to July 1, 1910, there shall be presented to the Trustee Company a certified copy of a resolution of the Board of Directors or Executive Committee of the Railway Company, directing the Trustee Company, to authenticate and deliver to the Railway Company, or its order, any instalment of the remaining Eleven million dollars (\$11,000,000), face value, of said bonds, accompanied by a written order signed by the President or Chairman of the Executive Committee and by the Secretary or Treasurer of the Railway Company, directing the delivery of such instalment, forthwith the Trustee Company shall authenticate an amount of said bonds which in face value shall equal the instalment specified in said order, and shall deliver the same as directed therein, and said bonds, or any part thereof, may be sold, pledged, hypothecated, or otherwise disposed of by the Railway Company, at such time, and from time to time, and in such manner and for such of the purposes set forth in the preceding paragraph as may be determined by the Board of Directors or Executive Committee of the Railway Company.

(d) Any new property so constructed or acquired with the proceeds of said bonds shall forthwith and ipso facto become and be subjected to the lien and operation of this Indenture, and the Rail-

way Company, from time to time, shall execute or shall cause to be executed and delivered in due form of law, all such deeds, conveyances and instruments of further assurance as shall be necessary for effectually subjecting to the lien and operation of this Indenture all such property, as the Trustees shall request.

6. Until the permanent Refunding and Improvement Bonds to be issued under and secured by this Indenture can be engraved or lithographed, the Railway Company may execute, and, upon its request, the Trustee Company shall authenticate and deliver in lieu of such permanent bonds, subject to the same provisions, limitations and conditions, temporary Refunding and Improvement

Bonds of the denomination of One thousand dollars (\$1,000) each, or any multiple thereof, substantially of the tenor of

the permanent Refunding and Improvement Bonds to be issued hereunder (but without coupons), or temporary receipts entitling the holder thereof to said permanent Refunding and Improvement Bonds when ready for delivery. Upon surrender to the Trustee Company of such temporary Refunding and Improvement Bonds or receipts for exchange the Railway Company shall execute, and upon cancellation of such surrendered bonds or receipts, the Trustee Company shall authenticate and deliver in exchange therefor, and as representing the same debt, an equal amount face value of permanent engraved or lithographed Refunding and Improvement Bonds, substantially in the form hereinbefore set forth, and until so exchanged the temporary bonds or receipts shall be entitled to the same security as the permanent Refunding and Improvement Bonds issued hereunder.

7. In case any Refunding and Improvement Bonds with coupons, if any, thereto belonging, shall become mutilated or be destroyed or lost, the Railway Company in its discretion may issue, and upon the written request of its President or one of its Vice-Presidents, approved by resolution of its Board of Directors or Executive Committee, the Trustee Company shall authenticate and deliver a new Refunding and Improvement Bond of like denomination, tenor and date (including in the case of a coupon bond the coupons, and the same serial number) as that of the bond so mutilated, destroyed or lost in exchange and in substitution for and upon the cancellation of the bond so mutilated, or in lieu of or in substitution for the bond so destroyed or lost. The applicant for such substituted bond shall furnish to the Railway Company and to the Trustee Company evidence satisfactory to each of them of the destruction or loss of such bond, and the said applicant shall also furnish indemnity satisfactory to the Railway Company and to the Trustee Company.

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## Article Second.

### Trust Estate Prior to Default.

1. Until default shall be made in the payment of the principal and interest of the Refunding and Improvement Bonds or of some part thereof, or in the performance of some covenant or condition

herein expressed to be performed by the Railway Company, whereby the security hereby created shall become enforceable, the Railway Company shall have the right to remain in possession and to retain exclusive control of the Trust Estate, except such shares and securities of other corporations as shall be held by the Mercantile Trust Company and Selwyn C. Edgar under the above described trust mortgage of Thirty million dollars (\$30,000,000), dated April 2nd, 1900, and said supplemental mortgage dated January 15, 1902, or by the Trustees hereunder, and shall be entitled to manage, use, operate and enjoy the same, and to collect, take and use the earnings, profits, income and revenues thereof, including the dividends, income, and interest from shares and securities of other corporations so held by the Mercantile Trust Company and Selwyn C. Edgar, or by the Trustees hereunder, except as herein otherwise provided, and to apply the same to the current expenses of the Railway Company, and to such other legitimate uses as may not be inconsistent with the provisions of this instrument, and may do all such other things as may be necessary or convenient in the proper conduct of its business.

If when the Refunding and Improvement Bonds shall have become due and payable, the Railway Company shall well and truly pay or shall cause to be paid the whole amount of the principal moneys and the interest due upon all of said Refunding and Improvement Bonds and the coupons for interest appertaining thereto and then outstanding, or shall provide for such payment by depositing with the Trustees hereunder for the payment of such bonds and coupons the entire amount due thereon for principal and interest, and also shall pay or cause to be paid all other sums payable

hereunder by the Railway Company, and shall well and truly  
 840 keep and perform all the things herein required to be kept and performed by it according to the true intent and meaning of this Indenture, then and in that event all property rights and interests hereby conveyed shall revert to the Railway Company, and the estate, right, title and interest of the Trustees shall thereupon cease, determine and become void, and the Trustees on demand of the Railway Company and at its cost and expense shall enter satisfaction of this Indenture upon the record; otherwise the same shall be continued and shall remain in full force and effect.

2. Upon the written request of the Railway Company, approved by resolution of its Board of Directors or Executive Committee, the Trustees, from time to time, while the Railway Company is in possession of the railroads constituting part of the Trust Estate, but subject to the conditions and limitations in this section prescribed, and not otherwise, shall release from the lien and operation of this Indenture, any part of the railroads, equipment and other property, real and personal, comprising part of the Trust Estate, other than the pledged stocks and bonds, provided: (1) that no part of the lines of track or of the rights of way shall be released until the same shall no longer be of use in the operation of any of the mortgaged lines of railway, and no part of such lines of track or rights of way shall be so released if thereby the continuity of the principal

lines of railway of the Railway Company shall be broken; and (2) that no part of the mortgaged railways or other property shall be released hereunder unless at the time of such release it shall no longer be necessary or expedient to retain the same for the operation, maintenance or use of the other lines of railway or for use in the business of the Railway Company.

Any of the stocks and bonds pledged hereunder may in like manner be released from the lien of this Indenture, provided (1) that they be stocks or bonds of a corporation, no part of whose lines of track, rights of way or property shall any longer be of use in the operation of any of the mortgaged properties, or of any other lines of railway or other property owned by any other corporation, a majority of the capital stock or voting control of which is at the time pledged hereunder, and (2) that by such release the continuity of the principal lines of railway operated by the Railway Company or by any such other corporation, will not be broken, and (3) provided further that they be stocks or bonds of a corporation whose railways or other properties shall no longer be necessary or expedient for the maintenance, use or operation of the other lines of railway of the Railway Company or of any other corporation, a majority of the capital stock or voting control of which at the time is mortgaged or pledged hereunder, or for use in the business of the Railway Company or of any such other corporation.

No such release shall be made unless the Railway Company shall have sold or exchanged for other property of equal value or shall have contracted to exchange for other property of equal value, or to sell the property so to be released, and unless some other disposition thereof be required by some prior lien, the cash proceeds arising from any and all such sales, and all moneys received for any property subject to this Indenture taken by the power of eminent domain, shall be deposited with the Trustees and shall be set apart and held in trust by them, and paid by them to the Railway Company, or its order, from time to time, upon the order of the Railway Company, to be expressed by a resolution of its Board of Directors or Executive Committee, a copy of which, certified under its corporate seal, shall be lodged with the Trustee Company, stating that the instalment of money requested is to be applied by the Railway Company to the purchase of other property, real or personal, or for improvements of or additions to, or for equipment or rolling stock on said mortgaged lines, or to reimburse the Railway Company for moneys expended by it for one or more of such purposes. Such resolution shall state the cost of the property so to be acquired or for which reimbursement is sought, which shall not be less than the amount of the payment requested. Such resolution shall constitute sufficient warrant, direction and justification to the Trustees for the payment of moneys as therein and thereby requested.

Pending such application, as aforesaid, the Trustees when requested by a resolution duly adopted by the Board of Directors or Executive Committee of the Railway Company shall invest tempo-

842 rarely any moneys deposited with them in accordance with the terms of this section in Refunding and Improvement Bonds, or in any of the prior bonds, at prices designated and requested in writing by the Railway Company. The bonds so purchased shall be held by the Trustees as part of the Trust Estate hereby created, but shall be sold by them whenever requested so to do by resolution duly adopted by the Board of Directors or Executive Committee of the Railway Company, and at such price or prices, and upon such terms, and in such manner as the Railway Company by like resolution may direct, and the proceeds arising upon any such sale of bonds shall be held by the Trustees upon the same trusts as the moneys invested in such bonds were held by them.

Any new property acquired by the Railway Company in exchange for or with the proceeds of property released hereunder, *ipso facto*, shall become and be subject to the lien of this Indenture as fully as if specifically mortgaged or pledged hereby, subject, however, to any mortgage or deed of trust then underlying this Indenture so far as may be required by the terms thereof; but if requested by the Trustees, the Railway Company will convey the same to the Trustees, subject, however, as aforesaid, by appropriate deeds, upon the trusts and for the purpose of this Indenture.

Unless some other disposition thereof be required by the First Mortgage to The Mercantile Trust Company and Selwyn C. Edgar, as Trustees, any and all securities received by the Railway Company in payment or exchange for any bonds or stocks pledged hereunder and released shall at once be delivered to and pledged with the Trustees hereunder and be held by them subject to the lien of this Indenture, or if required to be pledged with the Trustees of the First Mortgage, shall be delivered to them and shall be charged, subject to such pledge, with the lien of this Indenture.

The Railway Company while in possession of the mortgaged railways also shall have full power, in its discretion, from time to time, to dispose of any portion of the machinery, equipment, implements and other like property at any time held subject to the lien hereof, which may have become obsolete or otherwise unfit for use, replacing the same by new machinery, equipment or imple-  
843 ments, and other like property, which shall become subject to this Indenture. In case the mortgaged railways shall be

in the possession of a receiver, lawfully appointed, the powers in and by this Article conferred upon the Railway Company may be exercised by such receiver with the approval of the Trustees; and if the Trustees shall be in possession of the mortgaged railways under any provision of this Indenture, then all the powers by this Article conferred upon the Railway Company may be exercised by the Trustees in their discretion. The Railway Company, from time to time, may make changes or alterations in, or substitutions of any leases, or track or rights subject to this Indenture, but in any such event any modified, altered or substituted leases or trackage rights forthwith shall become bound by and be subject to the terms of this Indenture, in the same manner as those previously existing. A cer-

ificate signed by the President or a Vice-President and by the Comptroller or Auditor, or Treasurer or Assistant-Treasurer of the Railway Company, may, except as hereinbefore otherwise expressly provided, be received by the Trustees as conclusive evidence of any of the facts mentioned in this Article and shall be full warrant and protection to the Trustees for their action on the faith thereof.

In no event shall any purchaser or purchasers of any property sold or disposed of under any provision of this Section be bound to inquire into the existence of any fact which, under the provisions of this Section, authorizes the Trustees to execute such release, nor shall they be bound to see the application of the purchase moneys.

3. Any shares of stock or bonds or other securities which the Trustees now are or which they at any time hereafter may become entitled to hold subject to the lien hereof shall be duly assigned, transferred and delivered to the Trustees by the Railway Company, provided that a sufficient number of shares to qualify directors may be retained by the Railway Company, but shall nevertheless be deemed part of the Trust Estate and subject to the other provisions hereof. The Trustees shall have the right to have any stock which may be delivered to them hereunder registered in their names or in the name of the Trust Company, or any nominee of the Trust Company, or otherwise, or they may receive and hold

such stock or certificates in the name of the Railway Company or any one else, endorsed in blank, or with a blank power of assignment or attorney, or in any other manner they see fit; and may hold the bonds pledged hereunder as bearer bonds, or otherwise as they see fit. Any shares, bonds or other securities comprised in the Trust Estate which are subject to a lien prior to the lien of these presents shall be, whenever such lien shall be discharged, in like manner assigned, transferred and delivered to the Trustees hereunder; and the Railway Company constitutes and appoints the Trustees, in the event of the payment of any such lien prior to the lien of these presents, attorneys irrevocable for it, to demand and receive from the Trustees of such prior lien said shares, bonds or other securities held by them, and to receipt for the same as fully in all intents and purposes as the Railway Company could but for these presents. The Railway Company further expressly authorizes and directs the trustees under the First Mortgage, on the satisfaction of the First Mortgage, to deliver to the Trustees hereunder all bonds and obligations and all certificates of stock or for shares of stock held under said First Mortgage.

The Trustees shall be entitled to receive and hold as part of the Trust Estate (a) any and all dividends not payable out of earnings which may be declared and become payable in respect of any shares pledged hereunder; (b) all payments on account of the principal of any bonds or other securities pledged hereunder; (c) all moneys received upon the liquidation of any company whereof any shares of capital stock shall be pledged hereunder. Any and all moneys which the Trustees shall at any time receive under the provisions of (a), (b) and (c) shall be received, held and disposed of by them in the manner and upon the trusts set forth in Section 2 of this

Article with respect to the proceeds of released property. Until a default by the Railway Company in the performance of some covenant or agreement herein contained to be performed by it, whereby the security hereby constituted shall become enforceable, the Railway Company, by its officers thereunto duly authorized, shall be entitled to vote upon all shares pledged and hypothecated hereunder at any regular or special meeting of the corporation issuing the

845 same, with the same force and effect as though these presents had not been executed, subject, however, to such limitations as may be contained in the covenants herein set forth; and may receive, enjoy and dispose of, free from the lien hereof, any dividends, payable out of earnings, interest, income, rights or benefits arising in respect of such shares, or upon or with respect to any bonds or other securities pledged and hypothecated hereunder; subject, however, to the covenants and conditions hereinafter contained. The Trustees, until any such default by the Railway Company, when and as requested by the Railway Company by resolution of its Board of Directors or Executive Committee, shall execute and deliver suitable dividend orders, coupons for interest, powers and proxies for the aforesaid purposes, and pay over all dividends, interest, income, rights or benefits received by them, or either of them, with respect to the securities pledged hereunder; subject, however, to the limitations hereinafter set forth.

The Trustees shall be entitled to assume that any interest received by them on any bond or other obligation, claim of indebtedness, or any dividend received on any shares of stock, is paid out of rents, revenues, earnings, proceeds of operation or income, unless they are notified in writing to the contrary, and in the absence of any such written notification it shall be conclusively presumed, as between the Trustees and the bondholders, that the Trustees, in making any payments thereof to the Railway Company, acted in good faith. In any case of continued default on the part of the Railway Company, specified in Section 2 of Article 3 of this Indenture, then during the continuance of such default, in addition to all the other remedies herein provided, the Trustees may revoke any such proxy or proxies and dividend orders, but after such default shall have been made good or shall have been waived, the right of the Railway Company to vote upon all such shares of stock, and to receive such dividends on such stock, and such interest on such bonds and securities, and the respective duties of the Trustees and the Railway Company to execute such proxies and dividend orders shall revive and continue as though such default had not taken place.

846 4. Upon default by the Railway Company in the performance of any condition herein contained to be performed by it, whereby the security hereby constituted shall become enforceable, and during the continuance of such default, the Trustees shall have the right, subject to the provisions of the first mortgage to The Mercantile Trust Company and Selwyn C. Edgar and said supplemental mortgage above referred to, to vote upon all shares pledged hereunder at all meetings and for all purposes, and may



retain all dividends, income, rights and benefits received by them in respect of said shares, and hold and dispose of the same as part of the Trust Estate hereby created. But if all defaults of the Railway Company shall be made good before any sale of the Trust Estate upon default as hereinafter provided, the rights of the Railway Company hereunder in and to the said shares, bonds or other securities, and in and to the dividends, income, rights and benefits arising in respect thereof, and not theretofore applied by the Trustees for any of the purposes of the trust as herein authorized, shall be restored in all respects as if such default had not been made:

5. Nothing contained in this Indenture or in any bond hereby secured shall prevent any consolidation or merger of the Railway Company with any other corporation, or any conveyance and transfer subject to the continuing lien of this Indenture, and to all the provisions thereof, of all the mortgaged premises as an entirety to a railroad corporation at that time existing under and by virtue of the laws of any state or states, or of the United States, and entitled to acquire the same, provided, however, that such consolidation mortgage or sale shall not impair the lien and the security of this Indenture or any of the rights or powers of the Trustees or of the Bondholders hereunder, and that upon any such consolidation, merger or sale due and punctual payment of the principal and interest of all said bonds secured hereby according to their tenor and the due and punctual performance and observance of all the covenants and conditions of this Indenture shall be assumed by the corporation formed by such consolidation or merger or purchasing as aforesaid.

6. In case the Railway Company shall be consolidated or merged with any other corporation, or shall sell, convey and transfer, subject to this Indenture, all the mortgaged premises as an entirety as aforesaid, the successor corporation formed by such consolidation or into which the Railway Company shall have been merged, or which shall have purchased and received the conveyance and transfer as aforesaid upon executing and causing to be recorded an Indenture with the Trustees, satisfactory to the Trustees, whereby such successor corporation shall assume the due and punctual payment of the principal and interest of the Refunding and Improvement Bonds and the performance of all the covenants and conditions of this Indenture, shall succeed to and be substituted for the Railway Company, party of the first part hereto, to the same effect as if it had been named herein as such party of the first part, and such successor corporation thereupon may cause to be signed, and may sue, either in its own name or in the name of The Kansas City Southern Railway Company, any or all of the Refunding and Improvement Bonds which shall not theretofore have been signed on behalf of the Railway Company, and authenticated by the Trustee Company, and upon the order of said successor corporation, in lieu of the Railway Company and subject to all the terms, conditions and restrictions herein prescribed, the Trustee Company hereunder shall authenticate and deliver any such bonds which shall have been previously signed and delivered by the officers of the Railway Company to the said Trustee Company for authentication, and any such

bonds which such successor corporation shall thereafter cause to be signed and delivered to the said Trustees for that purpose. All bonds so issued shall in all respects have the same rank and security as bonds theretofore or thereafter issued, in accordance with the terms of this Indenture.

6. For every purpose of this Indenture, including the execution, issue and use of any and all Refunding and Improvement Bonds hereby secured, the terms "Railway Company" and "The Kansas City Southern Railway Company" mean not only the party of the first part hereto but also any such successor corporation. Every such successor corporation shall possess, and from time to time may exercise, each and every right and power hereunder of The Kansas City

Railway Company, in its name or otherwise. Any act or proceeding by any provision of this Indenture required to be done performed or instituted by any Board or officer of the Railway Company, shall and may be done, performed and instituted with like force and effect by the like Board, or officer in the railroad corporation that shall at the time be such lawful sole successor of the Railway Company.

7. Nothing herein contained shall prevent the merger or consolidation, whenever authorized by law, of any corporation the shares or bonds of which are pledged hereunder with the Railway Company, or with any other corporation of which a majority of the capital stock is pledged and hypothecated hereunder, or the sale and conveyance, whenever authorized by law, by such corporation of all its property, assets and franchises to the Railway Company, or its successors or nominees, or to any other company of which a majority of the capital stock shall be pledged and hypothecated hereunder; and if such consolidation, merger, sale or conveyance shall contemplate the cancellation or delivery of any shares or bonds comprised in the Trust Estate, with or without the issue in exchange therefor of new shares or bonds, or shares in another corporation formed by such consolidation or merger, or otherwise; the Trustees may consent to such cancellation or delivery and exchange, if in their opinion the security afforded by these presents is not thereby impaired; and the Trustees in determining whether the security hereby afforded has been so impaired may rely absolutely and exclusively on the judgment of one or three disinterested persons who may be appointed by the Trustees at the expense of the Railway Company, and who shall be liable in no way except for their own willful default. But no such cancellation or delivery and exchange shall be permitted if the Railway Company shall be in default in respect of any of the provisions hereof and shall have ceased to retain possession of the mortgaged premises.

In the event of the consolidation or merger of any one or more of the said Companies with, or the sale of its properties, assets and franchises to the Railway Company, this Indenture shall immediately become and be a lien upon the property of the Company so consolidated and merged with, or sold to, the Railway Company, with the same force and effect as if expressly conveyed by this Indenture.

849 8. At any time, if requested in writing by the Railway Company, the Trustees shall consent to the extension or renewal of any bonds or other obligations which may from time to time be held hereunder, or any other bonds, or other obligations, and the extension or renewal of any mortgage or lien securing such bonds or other obligations; provided the Railway Company shall not at the time be in default hereunder, and provided further that the maker of such bonds or other obligations shall not at the time be in default thereunder; and at any time, if the Trustees shall deem it advisable, the Trustees shall so consent notwithstanding there be such a default and notwithstanding there be no request from the Railway Company. And at any time so long as the Railway Company shall not be in default hereunder, the Trustees, if requested in writing by the Railway Company, may consent to the exercise by the Railway Company of any other right, power or remedy with respect to such bonds or other obligations to which it may be entitled as the owner thereof; provided that the exercise of such right, power or remedy as contemplated by the Railway Company shall not in the opinion of the Trustees be prejudicial to the interests of the Trustees or the holders of the Refunding and Improvement Bonds under this Indenture and the Railway Company covenants that in exercising any such right, power or remedy if so accorded to it by the Trustees it will not in any way prejudice the interests or rights hereunder of the Trustees or the holders of the Refunding and Improvement Bonds or coupons appertaining thereto.

Whenever all the bonds or other obligations of any other corporation deposited or entitled to be deposited with the Trustees hereunder, or any of them, shall be paid or satisfied, the Trustees at the expense of the Railway Company may, but shall not be obliged to, cause to be cancelled all such bonds or other obligations held hereunder, and take such steps as may be necessary to procure the release or satisfaction of any deed of trust or other instrument securing the same. The Trustees may at any time take such steps by suit or otherwise as they shall deem advisable to protect their interests and the interests of the bondholders hereunder in respect of any bonds, notes, obligations, claims or stocks, which may be subject to the lien hereof; and the Trustees, if they shall deem it advisable, may join in any capacity in any plan of reorganization or readjustment in respect of any such bonds, notes, obligations, claims or stocks, and may accept new securities issued under such plan, and generally, subject only as in this Indenture specifically restricted, and to the actual exercise by the Railway Company of the rights in respect thereof conferred by this Indenture, the Trustees shall have, and may exercise, all the rights of owner in respect of the bonds, obligations or stock held by the Trustees in any manner, at any time, under the trusts hereof.

50 The Trustees may receive the opinion of counsel for the Railway Company or any other counsel as to the legal effect of any step necessary to be taken in connection with any matter under sections

5, 6, 7 and 8 of this article, and such opinion shall be full protection to the Trustees for any action by them taken or suffered pursuant thereto.

### Article Third.

#### Remedies Upon Default.

1. If the Railway Company shall make default in the payment of the interest on any of the Refunding and Improvement Bonds and such default shall have continued for six months, then and thereupon the Trustees may in their discretion, and if the holders of a majority in interest of the Refunding and Improvement Bond at the time outstanding, shall in writing so request, they shall declare by notice in writing delivered to the president, secretary or treasurer of the Railway Company or mailed to it at Kansas City, Mo., the principal of all the Refunding and Improvement Bonds to be immediately due and payable, and thereupon the same shall forthwith be and become due and payable, anything in said bond or in this Indenture to the contrary notwithstanding. But the holders of three-fourths in interest of the said bonds at the time outstanding, by written notice to the Railway Company and to the Trustee Company, may at any time prior to a sale withdraw such request or annul any action of the Trustees in this respect. No action taken by the Trustees or by the said holders of bonds in accordance with the foregoing shall in any way affect the

851 powers or rights of the Trustees or of the bondholders in the event of any subsequent default. Provided, however, that in the event of the sale of the Trust Estate under the power or trust for sale hereinafter contained, or pursuant to a decree of Court as hereinafter provided, the principal of all the Refunding and Improvement Bonds issued hereunder shall become forthwith due and payable, anything to the contrary herein contained notwithstanding.

2. In case (1) default shall be made in the payment of any interest on any of the Refunding and Improvement Bonds, when the same shall become payable as therein and herein expressed, and such default shall have continued for a period of six months, or (2) default shall be made in the payment of the principal of any Refunding and Improvement Bond when the same shall become due and payable, either by the terms thereof or otherwise as herein provided, or (3) default shall be made in the due and punctual payment of either principal or interest upon the First Mortgage running to The Mercantile Trust Company and Schwyn C. Edgar in the sum of Thirty million dollars (\$30,000,000), and the supplemental Mortgage above referred to, or in the bonds secured thereby, and such default in the payment of interest shall have continued for a period of six months, or (4) default shall be made in the due observance or performance of any other covenant or condition herein required to be kept or performed by the Railway Company, and such default shall have continued for a period of six months after written notice thereof shall have been given to the Railway Company by the Trustees, or (5) if the Railway Company shall go or be put into

bankruptcy or insolvency, or if a Receiver of its property or of the Trust Estate shall be appointed, or if it shall lose its charter by forfeiture, expiration or otherwise, then, and in each and every such case, the security hereby created shall become enforceable and the Trustees may proceed forthwith to enforce such security by any or all of the methods set forth as follows, to wit:

(a) The Trustees may in their discretion, either personally or by their agents or attorneys enter into or upon and take possession of all or any part of the Trust Estate and the property comprised therein, or intended so to be, and may exclude the Railway Company and its agents and servants wholly therefrom, and may use, manage and enjoy the same, and may use, operate, manage and control said railroads and other premises and property, and, subject to the provisions of law, may regulate the tolls for the transportation of passengers and freight thereon and conduct the business thereof, personally or by its managers, superintendents, receivers, agents, servants or attorneys, to the best advantage of the holders of the bonds hereby secured, and, upon every such entry, at the expense of the Trust Estate, from time to time the Trustees may maintain and restore, either by purchase, repair or construction, and may insure or keep insured, the rolling stock, tools, machinery and other property, buildings, bridges and structures erected or provided for use in connection with said railroads and other premises, and whereof they shall become possessed as aforesaid, in the same manner and to the same extent as is usual with railroad companies, and generally may do all things which in their discretion they may deem necessary for the proper maintenance and management thereof, including the making and providing, from time to time, at the expense of the Trust Estate, of all necessary or proper repairs, renewals, replacements, alterations, additions, betterments and improvements thereto and thereon, as to them may seem judicious; and may collect and receive all accounts, tolls, rents, incomes and profits thereof, and shall apply the moneys so received as follows:

First, to the payment of the expenses of the Trustees incurred in managing the Trust Estate and conducting the said business or otherwise incurred in respect thereof, including just remuneration for their own services and for the services of such managers, servants, counsel and attorneys as they may have employed.

Second, In case the principal of the Refunding and Improvement Bonds shall not have become due, to the payment of the interest in default in the order of the maturity of the instalments with interest at the rate of five per centum per annum on such overdue instalments, which payments shall be made ratably to the persons entitled thereto without discrimination or preference. But in case the principal of the Refunding and Improvement Bonds shall have become due by declaration, or otherwise, then to the payment of the interest due and unpaid upon the said bonds, with interest upon overdue instalments of interest, at the rate of five (5%) per cent. per annum and then to the payment of the principal thereof ratably and without discrimination or preference to the

persons entitled to such payment of principal and interest respectively.

These provisions are not intended in any way to modify the provisions of subdivision (c) of Article Fourth hereof.

In acting under the power of entry herein contained, the Trustees shall at all times regard the rights of The Mercantile Trust Company and Selwyn C. Edgar, as Trustees of the Mortgage and supplemental Mortgage above referred to, and the right of the holders of any prior bonds secured thereby. And in case all defaults of the Railway Company shall be made good, including the payment of all interest in arrears, and no event shall exist upon which the security hereby constituted shall be enforceable, the Trustees shall yield to the Railway Company the possession of the Trust Estate entered upon and not then sold, and such property shall thereupon be subject to all the trusts and provisions of these presents, in the same manner and to the same extent as if such entry had not been made.

(b) The Trustees in their discretion, may either with or without entry, and, upon the request of the holders of a majority in interest of the Refunding and Improvement Bonds at the time outstanding the Trustees shall cause the Trust Estate to be sold to the highest bidder at public auction, subject, however, to the above mentioned Mortgage held by The Mercantile Trust Company and Selwyn C. Edgar, any other mortgage supplemental thereto in so far as the same shall then affect the Trust Estate or any part thereof. Such sale shall be held in Kansas City, Missouri, and notice shall be given of the time and place of such sale by publication once a week for six consecutive weeks in at least two newspapers of general circulation published in each of the cities of Kansas City, Missouri, and New York City, New York, together with such other notice, if any as may be required by law. In the event of any sale hereunder whether under the power of sale or by virtue of judicial proceedings all of the Trust Estate shall be sold as an entirety unless, on the

holders of seventy-five per cent. in amount of the bonds  
854 hereby secured then outstanding shall, in writing, request

the Trustees to cause said Trust Estate to be sold in parcels which request shall specify the parcels and the order of sale thereof in which case the sale or sales may be made in such parcels and in such order as may be specified in such request; or (b) such request of the bondholders not having been made, such sale as an entirety shall be deemed by the Trustees to be impracticable by reason of some statute or other cause, in which case the Trustees may cause the Trust Estate to be sold in such parcels and in such order as they may determine. Any part of said Trust Estate may be sold at any other place or places within or without said State of Missouri, as may be specified in said notice, or other notice or notices similarly published and given, in case it shall be deemed desirable or necessary by reason of any statute so to make such sale. The Trustees shall have the power to adjourn any such sale from time to time in their discretion, with or without notice, and after such adjournment to make such sale without further notice at the time and place to which the same may have been adjourned. In case of any such sale

of sales the Trustees are hereby empowered to make and deliver to the purchaser or purchasers of said Trust Estate sold thereof good and sufficient deeds of the same, and shall deliver to the purchaser the securities purchased by him with good and sufficient instruments of transfer. Such sale and conveyance shall be a perpetual bar, both in law and equity, against the Railway Company, its successors and assigns, and all other persons claiming by, through or under it, from all right, title and claim in and to the Trust Estate so sold, and every part and parcel thereof. And upon any sale or sales purporting to be made in pursuance of the aforesaid power or trust for sale the purchaser or purchasers, or any subsequent purchaser or purchasers, shall not be bound to see or inquire whether any such request or notice, as aforesaid, has been made or given, or whether any default hereunder has been made, or as to the propriety or regularity of such sale, and the receipt of the Trustees for the purchase money shall discharge the purchaser or purchasers therefrom and from all liability to see to the application thereof. And as affecting the title to any property purchased at any such sale the facts set

forth in a written affidavit made by an officer, attorney or agent of the Trustees, and attached to the deed of conveyance, relating to the time and manner of giving any notice hereby required, shall conclusively be deemed true against all persons.

3. The Trustees shall apply the proceeds of such sale or sales:

First, to the payment of the costs and expenses incurred in respect of such sale, and in and by the execution of the trusts hereof, or otherwise, in respect of the Trust Estate including reasonable remuneration for the services of the Trustees, and of such managers, servants and attorneys as may have been employed by them.

Secondly, to the payment of the principal of the Refunding and Improvement Bonds at the time outstanding, and the interest thereon remaining due and unpaid, with interest at the rate of five per centum per annum on overdue instalments of interest, without any preference or priority whatsoever, either as to principal or interest. The balance of said proceeds, if any, shall be paid over to the Railway Company or to whomsoever shall be entitled thereto.

In case the proceeds remaining after the payment of said costs and expenses shall be insufficient to pay in full the said principal and interest, the same shall be apportioned ratably, and without preference or priority among all the holders of the Refunding and Improvement Bonds and the coupons thereto belonging and the interest due thereon according to the amounts held by them respectively.

These Provisions are not intended in anywise to modify the provisions of subdivision (c) of Article Fourth hereof.

4. Nothing hereinbefore contained shall be construed as limiting or taking away any rights of the Trustees or of the holders of the Refunding and Improvement Bonds, subject to the provisions hereof, to apply to any court of competent jurisdiction for a judgment or decree of foreclosure and sale, or any other right or remedy which they may have, either in law or in equity, to enforce the security

hereby created, or the specific performance of any covenant on the part of the Railway Company herein contained, and after default by the Railway Company in the payment of the principal or interest of any of the Refunding and Improvement Bonds, or in the performance of any other covenant herein contained whereby the security hereby created shall have become enforceable as aforesaid, the Trustees may, notwithstanding any request to sell hereinbefore mentioned, and upon the request of the holders of a majority in interest of the Refunding and Improvement Bonds, the Trustees shall forthwith institute such proceedings either at law or in equity, as they may deem proper for the foreclosure of this Mortgage, or for the sale of the Trust Estate, or otherwise, for the enforcement of the security hereby created, or for the protection of the rights and interests of the holders of the Refunding and Improvement Bonds. Upon filing a bill in equity or upon commencement of judicial proceedings, as provided herein, the Trustees shall be entitled to exercise the right of entry herein conferred, and any and all rights and powers herein conferred and provided to be exercised by the Trustees upon the occurrence and continuance of any default as hereinbefore provided, and, as a matter of substantial right, and without regard to the adequacy or inadequacy of the security, the Trustees shall be entitled to the appointment of a receiver of the premises and property hereby mortgaged and pledged, and of the tolls, earnings, revenue, rents, issues, profits and other income thereof, with such powers as the court making such appointment shall confer, and shall be entitled to the application by any such receiver of the net income for the benefit of the holders of the bonds issued hereunder, in accordance with the trusts herein declared, but notwithstanding the appointment of a receiver, the Trustees shall be entitled, as pledgees, to continue to retain possession and control of any stocks, bonds, cash and other property pledged or to be pledged with the Trustees hereunder. And in case of any sale in accordance with an order or decree of any court, the proceeds thereof shall be applied and deposited as far as possible in the same manner as is provided in respect of the proceeds of any sale made under and by virtue of the power of sale hereinbefore contained, and all stipulations and provisions herein contained with reference to the sale of the trust estate, if sold under such power of sale, shall be applied as far as the law and practice of the court directing such sale may permit.

5. No holder of any Refunding and Improvement Bond or coupon shall have any right to institute any suit, action or proceeding in equity or at law for the foreclosure of this indenture, or for the execution of any trust thereof, or for the appointment of a receiver, or for any other remedy hereunder, unless such holder shall have previously given to the Trustees written notice of such default and of the continuance thereof, as hereinbefore provided, nor unless, also, the holders of a majority in amount of the Bonds then outstanding shall have made written request upon the Trustees, and shall have afforded them reasonable opportunity, either to proceed to exercise the powers hereinbefore granted, or to



institute such action, suit or proceeding in their own name; nor unless, also, they shall have offered to the Trustees adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby; and such notification, request and offer of indemnity are hereby declared, in every such case, at the option of the Trustees, to be conditions precedent to the execution of the powers and trusts of this Indenture and to any action or cause of action for foreclosure or for appointment of a receiver, or for any other remedy hereunder; it being understood and intended that no one or more holders of the Refunding and Improvement Bonds or coupons shall have any right in any manner whatever to affect, disturb or prejudice the lien of this Indenture, by his or their action, or to enforce any right hereunder, except in the manner herein provided; and that all proceedings at law or in equity shall be instituted, had and maintained in the manner herein provided, and for the equal benefit of all holders of out-standing bonds and coupons.

6. Upon any sale of the Trust Estate, whether under the power of sale herein contained or pursuant to judicial proceedings, any holder of Refunding and Improvement Bonds, or the Trustees, on behalf of all the bondholders, shall have the right to bid for and to purchase the Trust Estate, or any part thereof, upon equal terms with other persons and upon compliance with the terms of sale may hold, retain and dispose of such property without further accountability therefor. And any purchaser or purchasers upon such sale shall be entitled to be allowed as paid in or towards satisfaction of the purchase money, such sums as shall be payable to him or

58 them out of the proceeds of such sale in respect of any of the Refunding and Improvement Bonds and coupons held by such purchaser or purchasers and the sum so allowed on account of each of the said bonds and coupons shall be marked thereon as paid.

7. The Railway Company shall not at any time take advantage in any way of any stay or extension law now or hereafter in force, nor any law now or hereafter in force, providing for the valuation, or appraisement of the Trust Estate, or any part thereof, prior to any sale or sales thereof, whether made under the powers herein contained, or pursuant to a decree of Court, or otherwise, nor after such sale shall the Railway Company claim or exercise any right under any law or statute now or hereafter in force to redeem the Trust Estate or any part thereof sold as aforesaid; and all said stay or extension laws, and laws providing for the valuation or appraisement of the Trust Estate or providing for the redemption of the same after sale, and all rights under the said laws are hereby expressly waived and released by the Railway Company.

In case any law, such as hereinbefore in this Section mentioned and referred to and now in force, of which the Railway Company might take advantage despite the provisions hereof, shall hereafter be repealed or cease to be in force, such law shall not be deemed to become or to constitute any part of the contract contained in this Indenture.

8. No delay or omission of the Trustees or of any holder of Re-

funding and Improvement Bonds to exercise any right or power accruing upon any default occurring and continuing as aforesaid shall impair any such right or power, or shall be construed as a waiver of any such default or a consent thereto; and every power and remedy given by this Indenture to the Trustees or to the bondholders may be exercised from time to time, and as often as may be deemed expedient by the Trustees or by the bondholders respectively as herein provided. Except as herein expressly provided to the contrary, no remedy herein conferred upon, or reserved to, the Trustees, or to the holders of the Refunding and Improvement Mortgage Bonds, is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative, and shall be in addition to every other remedy given hereunder, or now or hereafter existing at law or in equity or by statute.

8.9. 9. Nothing in this Article, or in any other Article of this Indenture expressed or implied is intended or shall be construed to give to any person or corporation, other than the parties hereto, and the holders of Refunding and Improvement Bonds issued under and secured by this Indenture any legal or equitable right, remedy or claim under or in respect of this Indenture, or under any covenant, condition or provision herein contained; all its covenants, conditions and provisions being intended to be and being for the sole and exclusive benefit of the said parties respectively as the case may be and of the holders of the Refunding and Improvement Bonds hereby secured.

10. Any request or other instrument required by this Indenture to be signed and executed by bondholders may be in any number of concurrent instruments of similar tenor, and may be signed or executed by such bondholders in person or by agent appointed in writing. Proof of the execution of any such request or other instrument, or of a writing appointing any such agent, and of the holding by any person of bonds, shall be sufficient for any purpose of this Indenture, if made in the following manner:

(a) The fact and date of the execution by any person of any such request or other instrument, or writing, may be proved by the certificate of any notary public, or other officer authorized to take acknowledgments of deeds to be recorded in any State, that the person signing such request or other instrument acknowledged to him the execution thereof, or by an affidavit of a witness of such execution.

(b) The amount of coupon bonds transferable by delivery, held by any person executing any such request or other instrument as a bondholder, and the amounts and issue numbers of the bonds held by such persons, and the date of his holding the same, may be proved by a certificate executed by any trust company, bank, bankers or other depository (wherever situated) if such certificate shall be deemed by the Trustees to be satisfactory, showing therein that, at the date therein mentioned, such person had on deposit with such depository the bonds described in such certificate. The ownership of registered coupon bonds, or of registered bonds without coupons,

shall be proved by the registers of such bonds. Such proof  
 860 shall be conclusive in favor of the Trustees with regard to  
 any action by them taken under such request or other instru-  
 ment.

The Trustees shall not be bound to recognize any person as a  
 bondholder, unless and until his title to the bonds held by him is  
 proved in the manner in this Indenture provided.

11. All rights of action under this Indenture, or under any of  
 said bonds, may be enforced by the Trustees without the possession  
 of the bonds or coupons, or the production thereof on the trial or  
 other proceedings relative thereto, and any such suit or proceedings  
 instituted by the Trustees shall be brought in their names as Trust-  
 ees, and any recovery of judgment shall be for the ratable benefit  
 of the holders of said bonds in accordance with the tenor of this  
 Indenture.

12. The Railway Company covenants that (1) in case default  
 shall be made in the payment of any interest on any Refunding and  
 Improvement Bond at any time outstanding and such default shall  
 continue for a period of six months, or (2) in case default shall be  
 made in the payment of the principal of any such bond when the  
 same shall become payable, whether upon the maturity of said bond  
 or upon a declaration as authorized by this Indenture, or upon a  
 sale as set forth in this Article, immediately upon demand of the  
 Trustees, the Railway Company will pay to the Trustees, for the  
 benefit of the holders of the Refunding and Improvement Bonds,  
 and coupons appertaining to coupon bonds then outstanding, the  
 whole amount which then shall have become due and payable for  
 interest or principal, or both, upon all such bonds or coupons, as the  
 case may be, with interest upon the overdue principal and instal-  
 ments of interest, at the rate of five per cent. per annum, and in case  
 the Railway Company shall fail to pay the same, forthwith upon  
 such demand, the Trustees, in their own names, and as Trustees of  
 an express trust, shall become entitled to recover judgment for the  
 whole amount so due and unpaid.

The Trustees shall be entitled, so far as may be lawful without  
 prejudice to the security afforded by this Indenture, to recover judg-  
 ment for the amount of the principal and interest of the said bonds  
 and coupons whenever the same shall have become due and payable  
 upon or after any of the defaults above specified, either before,  
 861 or after, or during the pendency of any proceedings for the  
 enforcement of the lien of this Indenture upon the property  
 mortgaged hereunder, and the right of the Trustees to recover such  
 judgment shall not be affected by any sale hereunder, or by the  
 exercise of any other right, power or remedy for the enforcement  
 of the provisions of this Indenture. No recovery of any such judg-  
 ment by the Trustees nor levy of any execution under any such  
 judgment upon property mortgaged by this Indenture or upon any  
 other property shall in any manner or to any extent affect the lien  
 of this Indenture or any of the rights, powers or remedies of the  
 Trustees hereunder, but such lien, rights, powers and remedies of

the Trustees and of the Bondholders shall continue unimpaired as before.

13. Any moneys collected by the Trustees under Sections 11 and 12 of this Article Third shall be applied by the Trustees, first, to the payment of the expenses, disbursements and compensation of the Trustees, their agents, servants and attorneys, and, second, to the payment of the amount then due and unpaid for principal and interest as aforesaid upon such bonds and coupons in respect of which such moneys shall have been collected, ratably and without any preference or priority of any kind (except as provided in subdivision (c) of Article Fourth hereof), according to the amounts due and payable on such bonds for principal and interest and coupons respectively at the date fixed by the Trustees for the distribution of such moneys upon presentation of the several bonds and coupons and stamping such payment thereon, if partly paid, and upon surrender thereof, if fully paid.

14. The Railway Company at any time before full payment of the Refunding and Improvement Bonds, and whenever it shall deem it expedient for the better protection and security of such bonds (although there be then no default entitling the Trustees to execute the rights and powers conferred by subdivision (a) of section 2 of Article Third hereof) may, with the consent of the Trustees, surrender and deliver to the Trustees full possession of the whole or any part of the Trust Estate, for any period, fixed or indefinite, and may authorize the Trustees to collect the dividends and interest on all shares of stock, bonds and other obligations subject to this

862 Indenture, and vote upon all shares of stock for any period, fixed or indefinite. In such event the Trustees shall enter into and upon the premises surrendered and delivered and shall take and receive possession thereof and may exercise such rights and powers for such period, fixed or indefinite as aforesaid, without prejudice however, to their right at any time subsequently and when entitled thereto by any provision hereof, to insist upon and maintain such possession and to exercise any such right, though beyond the expiration of any prescribed period; and the Trustees from the time of their entry shall work, maintain, use, manage, control and employ the premises and property into which they shall so enter in accordance with the provisions of this indenture, and shall receive and apply the income and revenues thereof and of the Trust Estate as provided in subdivision (a) of section 2 of Article Third hereof.

Upon application of the Trustees and with the consent of the Railway Company, if then there be no existing default entitling the Trustees to exercise the rights and powers conferred by subdivision (a) of section 2 of Article Third hereof, and without such consent if then there shall be such an existing default, a receiver may be appointed to take possession of and to operate, maintain and manage the whole or any part of the property subject to this Indenture, and the Railway Company shall transfer and deliver to such receiver all such property wheresoever the same may be situated, and in either case when a receiver of the whole or of any part of said property shall be appointed pursuant to the provisions of this section or otherwise,

the net income and profits of such property shall be paid over to and shall be received by the Trustees for the benefit of the holders of the Refunding and Improvement Bonds; provided, however, that notwithstanding any such appointment the Trustees, as pledgees, shall be entitled to retain possession and control of any stocks, bonds, cash and other property pledged or to be pledged with the Trustees hereunder.

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## Article Fourth.

## Covenants of the Railway Company.

The Railway Company covenants with the Trustees exclusively for the benefit of the Trustees and of the several holders for the time being of the Refunding and Improvement Bonds:

(a) That it is well seized in fee simple of all the mortgaged premises and property above described, and hath full right and lawful authority to convey the same, and that the same are free from all incumbrances, except the mortgages or deeds of trust and equipment agreements hereinbefore mentioned, and that all the mortgaged premises against all lawful claims the Railway Company will forever warrant and defend.

(b) That the Railway Company duly and punctually will pay the principal and interest moneys specified in the Refunding and Improvement Bonds and the coupons thereto belonging, according to the tenor of the same respectively, without deduction from either such principal or interest for any United States, State, Territorial or Municipal or other tax or taxes which the Railway Company, its successors or assigns, may be required to pay or deduct therefrom, and the Railway Company hereby covenants and agrees to pay all such tax or taxes.

(c) That the Railway Company will not, directly or indirectly, extend or assent to the extension of the time for payment of any coupon or claim for interest upon any of the Refunding and Improvement Bonds, and that it will not, directly or indirectly, be a party to or approve any such arrangement by purchasing or refunding said coupons or claims for interest, or in any other manner. In case the payment of any such coupon or claim for interest shall be so extended by or with the consent of the Railway Company, such coupon, or claim for interest, so extended shall not be entitled, in case of default hereunder, to the benefit or security of this Indenture, except subject to the prior payment in full of the principal of all the outstanding Refunding and Improvement Bonds, and of all coupons, and claims for interest, upon such bonds, the payment of which has not been so extended; the intention of this agreement being to prevent any accumulation after maturity of claims for interest and coupons upon Refunding and Improvement Bonds.

(d) That the Railway Company duly and punctually will pay the principal and interest moneys specified in the bonds secured by the mortgage in the sum of Thirty million dollars (\$30,000,000) running to The Mercantile Trust Company and Selwyn C. Edgar

above described, and the coupons thereto belonging according to the tenor of the same respectively, and that it will not suffer or permit any default to occur under any mortgage securing or intended to secure said bonds, and will fulfill its obligations in the equipment agreements above referred to.

(c) That the Railway Company punctually will observe and perform all obligations, and duly make all payments required by the terms of any lease or agreement comprised in the Trust Estate, so that the interest of the Railway Company in any such lease or agreement may be at all times preserved unimpaired as security for the Refunding and Improvement Bonds. Provided, however, that nothing herein contained shall require the Railway Company to make any such payment or to observe any such obligations so long as it shall in good faith and by appropriate legal proceedings contest its liability therefor.

(f) That the Railway Company will not, without the written consent of the holders of at least three-fourths in interest of the bonds issued hereunder and outstanding, vote to increase the capital stock of any corporation, the shares of whose stock are pledged hereunder, unless such increase shall be made upon such terms and conditions satisfactory to the Trustees as will insure the immediate issue or transfer, fully paid and non-assessable, to the Trustees as part of the Trust Estate of such part of said increase as may be required to maintain at all times in the hands of the Trustees, subject to the provisions hereof, the same or a greater proportion of the entire capital stock of the said corporation as was comprised in the Trust Estate at the time of such increase. Nor will the Railway Company, without the like consent of a like amount in interest of the bonds at the time issued and outstanding hereunder, under any proxy given it by the Trustees, vote to sell or otherwise dispose of or lease, (unless such lease be upon the express condition that it shall

865 terminate at the election of the Trustees in case of the occurrence and continuance of any case of default specified in

Section 2 of Article Third hereof, or at the option of the purchaser in case of a sale of the property upon the enforcement of the security hereof), the railroad of any company, shares of which shall have been pledged and assigned under this Indenture, or any part of the property of such company necessary to the operation thereof except such sale, lease or other disposal be made to the Railway Company or to some other company, the greater part of whose capital stock shall then be owned by the Railway Company subject to the lien of this Indenture.

(g) That the Railway Company at all times while and so long as the Refunding and Improvement Bonds or coupons remain unpaid, will insure, and keep insured, the Trust Estate, or so much thereof as is customarily insured, for a fair insurable value. The Trustees shall in no way be liable for the collection of any insurance moneys in case of such loss or damage. All sums received by the Railway Company by virtue of any such insurance shall be applied by it to making good the loss and damage, either by repairing the property damaged or replacing the property destroyed, or in additions or betterments to the Trust Estate, and the property so

substituted shall become subject to the lien of these presents as part of the Trust Estate.

(h) That the Railway Company punctually will pay all taxes, charges, assessments, and mechanics', laborers' or other liens, now, or at any time hereafter levied, laid, assessed or created upon the Trust Estate, or upon any part thereof, including all taxes and assessments upon any shares, bonds or other securities held by the Trustees hereunder, or upon the interest of the Trustees in the Trust Estate, or in said stock, bonds or securities, so that the lien of this Mortgage and the bonds secured hereby shall at all times during the continuance hereof be maintained unimpaired; provided, however, that the Railway Company shall have the right to contest any such tax, assessment or charge, and pending such contest, may delay or defer payment thereof.

(i) That the Railway Company will maintain, preserve and keep all and singular the Trust Estate with the fixtures and appurtenances thereunto belonging in thorough working order and repair, and will make all needful and proper renewals, replacements and repairs so that its traffic and business shall at all times be conducted with safety and expedition, and will at all times maintain, preserve and keep its railways and lines, with the apparatus, fixtures and appurtenances, in like repair and working order, and supplied with all necessary equipment and rolling stock, plainly marked with the name of the Railway Company, and will conduct its business and work its railways in an efficient manner, and will diligently preserve all the rights and privileges to it granted and conferred by the laws of the State of Missouri, or any other State, and will not suffer any of its licenses to exercise patents or patent rights or apparatus, or any of its rights, franchises or privileges to lapse or be forfeited so long as the same shall be necessary or convenient in carrying on its business, and will use reasonable efforts to obtain from time to time all necessary renewals and extensions of such rights, franchises and privileges, and such further licenses and rights in respect of said patents, instruments, equipments and apparatus as may be necessary in the lawful operation of the business of the Railway Company.

(j) That the Railway Company will pay to the Trustees all expenses incurred by the Trustees in the execution of the trusts hereof, and all sums of money, if any, that shall have been paid by the Trustees, or by any person interested in the trusts hereof, on account of any such taxes, charges, assessments or liens, or insurance moneys, in case of any default in respect thereof on the part of the Railway Company, as aforesaid, with interest at the rate of six per centum (6%) per annum from the time or times of such payments respectively.

(k) That the Railway Company, and every person having or claiming any estate, title or interest in or to the Trust Estate or any part thereof, will at all times do and execute every such deed, act, assurance and thing as the Trustees may reasonably require, or as shall be necessary for further and better assuring to and to the use of the Trustees and upon the trusts and for all the purposes herein expressed, all and every part of the Trust Estate, and for

effectually vesting in the Trustees upon the trusts and for the purposes aforesaid all property, rights and franchises now owned or hereafter acquired, conveyed hereby or intended so to be.

(b) That until this Indenture shall be discharged and canceled the Railway Company will not suffer any of the franchises or rights of any corporation issuing any shares of stock comprised in the Trust Estate to lapse or be forfeited, and will at all times when entitled so to do under the terms of this Indenture vote upon any such shares, to the end that such rights and franchises may be maintained in full force and effect so long as the same may be used or useful in the business of the said corporation.

(c) That in the event of any sale of the Trust Estate, or any part thereof under any power or trust herein contained, the Railway Company will, if and when required by the Trustees, or the purchaser execute to the Trustees or as the Trustees may direct formal conveyance or assurance of the Trust Estate so sold.

(d) That the Railway Company will not impede or delay, or attempt to impede or delay, the Trustees, or any of the holders of Refunding and Improvement Bonds, in foreclosing this Mortgage or otherwise enforcing their rights hereunder.

(e) That the Railway Company will duly record and file these presents as shall be required by law in order to preserve the lien of the same as a mortgage both of real and of personal property and all the property and franchises comprised in the Trust Estate hereby conveyed or intended so to be, and will furnish satisfactory evidence of recording and filing to the Trustees, and will furnish similar evidence of recording and filing every additional instrument which shall be necessary to preserve the lien of these presents upon all the Trust Estate until the principal and interest of the bonds hereby secured shall have been duly paid.

(f) The Railway Company will not issue, negotiate, sell or dispose of any of the Refunding and Improvement Bonds in any manner other than in accordance with the provisions of this Indenture and in issuing, selling, negotiating or otherwise disposing of the Refunding and Improvement Bonds from time to time well and truly it will apply or cause to be applied, the same or the proceeds thereof to and for purposes herein prescribed and to and for no other or different purpose.

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#### Article Fifth.

##### Discharge of Mortgage Upon Payment or Redemption of Bonds.

1. All the Refunding and Improvement Bonds at any time issued and outstanding hereunder (but not any part thereof) may be redeemed by the Railway Company, or its successors or assigns, on any day when interest becomes payable on any portion thereof by the payment of one hundred and five per cent. (105%) of the principal, together with accrued interest to the date of redemption at the office of the Trustee Company in the City of New York, New York. Notice of the election of the Railway Company to redeem such bonds shall be given at least sixty (60) days prior to the date fixed



for such redemption, by the publication thereof at least four (4) times in at least one daily newspaper published in Kansas City, Missouri, and in at least one daily newspaper published in the City of New York, New York, the first publication to be not less than sixty (60) days nor more than ninety (90) days prior to the date fixed for such redemption, and by mailing, not more than ninety (90) days and not less than sixty (60) days prior to the date fixed for redemption, such notice to each owner of a registered bond or of a coupon bond registered as to principal at his address if any then appearing on the registration books. The Railway Company shall deposit with the Trustee Company on or before the date in such notice specified as the date for such redemption, proof that said notice of redemption has been given by publication and by mail in the manner aforesaid and cash to the amount of the principal of the Refunding and Improvement Bonds issued and outstanding hereunder, and a premium of five (5%) per cent. thereon, together with all accrued interest on such bonds to the date fixed for redemption, and such deposit having been made, all interest on said bonds shall cease on the day in such notice specified as the date for redemption, and each Refunding and Improvement Bond then issued and outstanding, and all accrued interest thereon, so far as respects the security hereof, shall be deemed to have been paid and discharged on such date and shall cease to be secured by this Indenture, and all coupons appertaining to any of such bonds maturing after the date specified for such redemption shall be null and void, and any bondholder thereafter shall be entitled to look for payment of his bonds only to the Trustee Company, which shall be liable in respect of the sum deposited to meet such bonds, but no holder of any bond shall be entitled to interest on such deposit with the Trustee Company.

The whole amount of the principal of each registered bond, together with a premium of five per cent. and the interest thereon to the date so fixed for redemption, and the whole amount of the principal of each registered coupon bond, together with a premium of five per cent. shall be paid to the registered holder thereof. The whole amount of the principal of each coupon bond not registered as to principal, together with a premium of five per cent. and the coupons representing accrued interest to the date fixed for redemption, shall be paid to the respective holders thereof, such payment in each case to be made against the surrender of the bonds and in the case of coupon bonds, of all coupons appertaining thereto maturing after the date fixed for redemption. The bonds and coupons so surrendered shall be cancelled by the Trustee Company and by it shall be delivered to the Railway Company upon its written request.

After redemption and payment of the bonds issued and outstanding hereunder as above provided, no other bonds to be secured by this Indenture shall be authenticated or issued.

2. (a) Upon deposit with the Trustee Company of the moneys necessary so to redeem all the Refunding and Improvement Bonds at the time outstanding, and proof of publication and mailing of notice as hereinbefore provided; or (b) upon the production of all

the Refunding and Improvement Bonds at the time outstanding with all unmatured coupons pertaining thereto cancelled, or upon such other evidence of the payment of such Refunding and Improvement Bonds and cancellation of such coupons as the Trustee Company shall deem sufficient, and upon depositing with the Trustees sufficient funds with which to pay all coupons and interest matured and unpaid on said bonds; then and in either of such events upon the payment of all sums of money payable to the Trustees according to the provisions hereof, and upon the execution and delivery to the Trustee Company on behalf of the

870 Trustees of an agreement of the Railway Company to indemnify and hold harmless the Trustees and each of them from any liability incurred by them by reason of their having become or acted as Trustees under this trust, the Trustees shall at the request and cost of the Railway Company, or its successors or assigns, release and discharge the Trust Estate and every part thereof from the lien of these presents, and the Trustees shall cause this Indenture to be discharged of record.

3. All Refunding and Improvement Bonds and Coupons thereto belonging which shall be paid at any time shall be cancelled as received by the Trustees and then delivered to the Railway Company upon its request in writing.

4. Whenever the Railway Company shall have cancelled or procured the cancellation of ninety-five per cent. in amount of the Refunding and Improvement Bonds at any time issued hereunder and all unmatured coupons thereto appertaining, the Trustees upon the written request of the Railway Company, and upon the production of such Refunding and Improvement Bonds and Coupons so cancelled, or such other evidence of such cancellation as the Trustees shall think sufficient, shall release and discharge the Trust Estate and every part thereof from the lien of this mortgage as hereinbefore provided in case of the payment of the Refunding and Improvement Bonds at maturity; provided, however, that no such release or discharge shall be made by the Trustees unless and until the Railway Company shall deposit with the Trustees upon trust to apply to the payment of the remaining Refunding and Improvement Bonds outstanding, and the interest thereon, as it accrues, a sum of money equal to the principal of such remaining Refunding and Improvement Bonds and the interest thereon from the time of making such deposit to the day on which said bonds under the terms hereof shall be payable, and sufficient to pay all matured and unpaid coupons and interest, together with all sums of money payable to the Trustees according to the provisions hereof. All sums of money held by the Trustees and not paid out in accordance with the trusts expressed in this paragraph within six years from the date when said bonds shall become due and payable as aforesaid shall be returned to the Railway Company. The Trustee may accept the certificate of the Treasurer, or an Assistant Treasurer, of the Railway Company as to the number of the matured coupons at any time outstanding. The Trustees shall not be required to allow or to pay interest upon any moneys paid to them under the provisions of this paragraph.

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## Article Sixth.

## Concerning the Trustees.

The Trustees may employ such officers, agents, servants, attorneys and other assistants as they may reasonably require for the proper discharge of their duties hereunder, and may pay reasonable remuneration therefor, and may take legal advice in all matters connected herewith, and shall be entitled to receive reasonable remuneration for all services performed by them in the discharge of the trusts hereof, and compensation for all disbursements, costs and expenses made or incurred by them in the discharge of their duties hereunder and in the management of the trusts thereof, and all such remuneration, disbursements, costs and expenses are hereby constituted a lien upon the Trust Estate prior to the lien of the said Refunding and Improvement Bonds. All representations and recitals herein and in the bonds hereby secured set forth are made by and on behalf of the Railway Company, and the Trustees are and shall be in no way responsible therefor nor for any statements therein contained nor for any action or thing by them done by reason of any representation to them made by the Railway Company or any of its officers, and the Trustees shall be answerable only for their own individual acts, receipts, neglects and defaults, and not for those of the other Trustee or of any person employed by them and selected with reasonable care, nor for loss, unless the same shall happen through their own wilful default.

The Trustees shall not be bound to act as hereinbefore provided in accordance with any direction or request of the Railway Company, or of its Board of Directors, or of its Executive Committee, until a duly authenticated copy of the resolution or vote containing such direction or request shall have been delivered to the Trustees. The Trustees and each of them shall be protected in acting upon any notice, request, consent, certificate bond or other paper notice  
872 or document, and believed by them to be genuine and to have been signed by the proper party or parties, and upon any instrument or instruments purporting to be proper requests of the officers of the Railway Company or copies of resolutions or votes of the Board of Directors or of the executive committee of the Railway Company. And the Trustees shall not be responsible for insuring the Trust Estate or for renewing any policies of insurance, or for the sufficiency of the security comprised in this Indenture, or for keeping down taxes, charges, assessments or liens upon the trust estate, or otherwise as to the maintenance of the security hereby created, or be bound to ascertain or inquire as to the performance or observance of any of the covenants or agreements to be performed by the Railway Company, or as to the payment or discharge of taxes, charges, assessments or liens in respect of the Trust Estate, or otherwise; but the Trustees in their discretion may make or renew any such insurance or pay and discharge any such taxes, charges, assessments and liens or insurance moneys in case of any default in respect thereof by the Railway Company, and the Trustees

may require the Railway Company to keep them fully informed and advised as to the performance of the covenants and agreements aforesaid, and as to the condition of the Trust Estate. The Trustees shall be under no liability in respect to the validity and sufficiency of this Indenture and shall be under no obligation to see to the proper execution, record, registry or filing, re-record, re-registry or re-filing thereof or to the proper execution, record, registry or filing of any supplemental indenture or other instrument given hereunder. The Trustees shall not be obliged to give notice of the existence of this trust to any person or corporation whomsoever, nor shall the Trustees be in any way responsible for the application of Refunding and Improvement Bonds delivered to the Railway Company pursuant to the terms hereof or their proceeds. The Trustees shall not be required to take notice of any default hereunder unless and until notified in writing of such default by the holders of ten per cent. (10%) in amount of the bonds secured hereby issued and outstanding, which notice shall distinctly specify the default desired to be brought to the attention of the Trustees, and in the absence of any such notice the Trustees may for all the purposes of this Indenture conclusively assume that the Rail-

873 way Company is not in default hereunder, and that no default has been made with respect to the payment of the principal or interest of any prior bonds or obligations, or in the observance or performance of any of the covenants, agreements and conditions contained in the above-mentioned mortgage of Thirty million dollars (\$30,000,000) running to the Mercantile Trust Company and Selwyn C. Edgar, or other instruments pertaining thereto, or of the equipment agreements and the Trustees shall not be required to take any action in respect of any default unless requested to take action in respect thereof by a writing signed by the holders of not less than a majority in amount of the Refunding and Improvement Bonds then outstanding, and unless tendered reasonable indemnity against costs, liabilities and expenses as aforesaid. Any such notice or request or any other provision herein contained, shall in no way limit the discretion herein given to the Trustees to determine whether or not the Trustees shall take action with respect to any default or take action without any request. Whenever in this Indenture the existence of any situation, matter, conclusion of fact of any character, or the sufficiency or validity of any instrument, power or procedure, or of any proof or evidence of any fact of any character, shall be prescribed as a condition to any action or proceeding on the part of the Trustees, or either of them, or shall be necessary to be ascertained as a basis of information by them, or either of them, a certified copy of a resolution of the Board of Directors or Executive Committee of the Railway Company, together with a certificate of the President, Comptroller, Treasurer or Secretary of the Railway Company, shall be sufficient evidence of any such fact, situation, matter or conclusion, unless herein elsewhere provided to the contrary, and shall be complete protection to the Trustees, or any of them, for any act or proceedings upon the faith thereof. The Trustees may advise with legal coun-

sel, and any action under this Indenture taken or suffered in good faith by the Trustees in accordance with the opinion of counsel, shall be conclusive on the Railway Company and on all holders of Refunding and Improvement Bonds, and shall be full justification and protection to the Trustees. The Trustees shall be reimbursed for and be indemnified against any liability or damages which may be incurred or sustained by them or either of them by reason of their acting as Trustees or doing any of the things in this Indenture provided for, and shall be indemnified and held harmless against any liability, charge, cost or expense based upon or resulting from the fact that the Trustees or either of them make or have transferred into their names the certificate for any shares of stock or the title to any property, bond or other obligations subject to this trust agreement, and the Trustees and each of them shall be entitled to the protection of the lien of this Indenture for their compensation, expenses and disbursements, as well as indemnification against any liability or damage sustained or incurred by them in the premises, and shall be paid the total amount thereof before any payment out of the Trust Estate of, or on account of, Refunding and Improvement Bonds and coupons or interest payable in respect thereof. The Trustees may deem and treat the bearer of any Refunding and Improvement Bonds hereby secured, unless the same be registered as to principal as hereinbefore provided, and the bearer of any coupons, as the absolute owner of such Refunding and Improvement Bond or Coupons for the purpose of receiving payment thereof, and for all other purposes whatsoever, whether such Refunding and Improvement Bond or Coupons be overdue or not, and the Trustees shall not be affected by any notice to the contrary. The Trustees shall not be bound to recognize any person as a holder of Refunding and Improvement Bonds entitled to the benefit of the provisions hereof, or to take any action at his request, unless either such bonds shall have been deposited with the Trustees or unless the fact of such holding be established in the manner herein provided for proof thereof; and the Trustees shall not be compelled to do any act hereunder unless reasonably indemnified against loss, cost, liability and expense. Neither of the Trustees assumes any responsibility or liability whatsoever as to the genuineness, regularity, validity or ownership of any stock, bonds or other obligations, to be received by them or either of them in accordance with the terms of this Indenture.

The Trustees, or either of them, may acquire bonds or coupons secured hereby with the same rights they would have if they were of Trustees.

2. The Trustees or either of them may resign and discharge themselves from all the trusts hereby created by giving not less than sixty (60) days' notice in writing to the Railway Company, or such shorter notice as the Railway Company shall accept as sufficient, and shall execute and deliver such conveyance and instrument or instruments in writing to its, his or their successor, or successors duly appointed, as may be advisable and proper fully to transfer the trusts and the Trust Estate. The holders of

two-thirds in interest of the Refunding and Improvement Bonds at the time outstanding may at any time request the Trustees or either of them in writing to resign, whereupon, as soon thereafter as may be, said Trustee or Trustees upon the payment of its, his or their reasonable charges, expenses and disbursements made or incurred in respect to or in connection with the Trust estate, shall execute and deliver to its, his or their successor or successors such conveyance and instrument or instruments in writing as may be advisable and proper legally to transfer the said trusts and Trust Estate. In case of the resignation, disqualification, dissolution, refusal to act, or death, of any Trustee under this Indenture, a new Trustee shall be appointed by the Railway Company by an instrument in writing, executed by order of its Board of Directors and under its corporate seal. Thereupon the Railway Company shall publish notice of such appointment at least twice a week for three consecutive weeks in each of two newspapers published in the Borough of Manhattan, City and State of New York; and unless one-third in amount of the holders of said bonds then outstanding shall within ninety days from the date of such last publication make objection by an instrument in writing, stating the respective amounts of Refunding and Improvement Bonds held by them and their respective addresses, signed by them, and delivered to the Railway Company, the said appointment shall at the expiration of the said ninety days be construed as assented to and confirmed by the holders of the Refunding and Improvement Bonds secured hereby. In case said objection by one-third in amount of the holders of said Bonds shall be so made as aforesaid the Railway Company shall then apply to some Court of competent jurisdiction to appoint such new Trustee as to such Court shall seem meet, and at least ten days' notice of such application shall be given by mail to such objecting bondholders at the addresses stated in their notices of objection.

876 3. One of the Trustees shall always be a Trust Company, doing business in the City of New York, New York, having a capital and surplus of not less than one million dollars, if there be such a Trust Company competent to execute the trusts hereof, and willing to accept the same.

Until the principal amount of the Refunding and Improvement Bonds shall become payable under the provisions therein or herein contained, or until the Trustees under the provisions hereof become entitled to enter upon the mortgaged premises, the Trustee Company, or any Trust Company appointed as Trustee Company hereunder in succession to it, may solely have and exercise the powers, and shall duly be charged with the performance of the duties hereinbefore declared on the part of the Trustees to be had and exercised or to be performed, including the right to declare due the principal of the said bonds. Any action or proceeding by the Trustee Company, or by any trust company appointed in succession to it, to the individual Trustee hereunder, or any Trustee appointed in succession to him, shall be sufficient warrant for the individual Trustee or his successor, taking such actions as may be so requested. Such individual Trustee, or any successor, may delegate to the

Trustee Company the exercise of any power, discretionary or otherwise, conferred by any of the provisions of this Indenture.

So long as the bonds or other securities pledged hereunder shall remain so pledged, any instrument required or property to be executed or action required or proper to be taken under the mortgage or agreement securing the same, by the Trustees as holders or pledgees of such bonds or other securities, may be executed or taken by the Trustee Company alone and such instrument or action shall have the same effect as if executed or taken by both the Trustee Company and the individual Trustee hereunder.

Any notice, request or other writing by or in behalf of the bondholders delivered solely to the Trustee Company or its successor in the trust, shall be deemed delivered to all the Trustees hereunder as effectually as if delivered to each of them. All cash collected by or payable to the Trustees shall be paid to and deposited with the Trustee Company, and any moneys at any time coming into the hands of any Trustee other than the Trustee Company shall be at once paid over to the Trustee Company. All the estates, 577 right, title and interest by this Indenture conveyed, assigned or transferred to the Trustees, are conveyed, assigned or transferred to them as joint tenants and not as tenants in common; and the custody of all the bonds and other property held by the Trustees under this Indenture and all rights, powers and duties with respect to the administration, management and disposition thereof shall remain with the Trustee Company.

#### Article Seventh.

##### Waiver of Personal Liabilities.

No recourse under or upon any obligation, covenant or agreement of this Indenture, or of any Refunding and Improvement Bond, or any coupon thereto belonging shall be had against any incorporator, stockholder, officer, or director of the Railway Company, or of any successor, corporation, either directly or through the Railway Company, by the enforcement of any assessment, or by any legal or equitable proceeding by virtue of any statute or otherwise, it being expressly agreed and understood that this Mortgage and the Refunding Improvement Bonds hereby secured are solely corporate obligations, and that no personal liability whatsoever shall attach to, or be incurred by the incorporators, stockholders, officers or directors of the Railway Company, or of any successor corporation, or any of them, because of incurring indebtedness hereby authorized, or under or by reason of any of the obligations, covenants or agreements contained in this indenture, or in any of the Refunding and Improvement Bonds or coupons thereto belonging, or implied therefrom, and that any and all personal liability of every name and nature, either at common law or in equity, or by statute or otherwise, of every incorporator, stockholder, officer or director, is hereby expressly waived, as a condition and in consideration of the execution of this Indenture and of the issue of Refund-

ing and Improvement Bonds and the coupons thereto belonging and the acceptance and ownership of any of said Refunding and Improvement Bonds shall be deemed to be and shall be conclusive evidence against the person so holding or owning the same that he has in all respects assented to the waiver of all such personal liability on the part of any such incorporator, stockholder, officer or director.

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## Article Eighth.

## Sundry Provisions.

1. All the covenants, stipulations, terms and agreements in this Indenture contained, by or in behalf of the Railway Company shall bind its successors and assigns, whether so expressed or not and the powers hereby conferred upon the Railway Company and its officers may be exercised, subject to the conditions herein provided, by the successor or successors from time to time of the Railway Company in the ownership of the entire Trust Estate, and any board or officer of such successor or successors may do and perform with like force and effect any act or proceeding which any provision of this Indenture may require any board or officer of the Railway Company to do or to perform.

Any Company into which the Trustee Company may be merged or with which it may be consolidated, or any Company resulting from any merger or consolidation to which the Trustee Company shall be a party, shall be the successor to the Trustee Company hereunder, without the execution or filing of any paper or any further act on the part of any of the parties hereto; anything herein to the contrary notwithstanding.

2. As to all registered bonds and all coupon bonds registered as to principal, the person in whose name the same shall be registered shall, for all purposes of this Indenture, be deemed and regarded as the owner thereof, and thereafter payment thereon of the principal, if such bond shall be a coupon bond registered as to principal, and of the principal and interest if it be a registered bond—shall be made only to or upon the order of such registered holder thereof, but such registration may be changed as hereinbefore provided; all such payments shall be valid and effectual to satisfy and discharge liability upon such bonds to the extent of the sum or sums so paid.

The Railway Company and the Trustees may deem and treat the bearer of any coupon bond which shall not at the time be registered as to principal, and the bearer of any coupon for interest upon such bond, whether such bond shall be registered or not, as the absolute owner of such bond or coupon for the purpose of receiving payment thereof and for all other purposes whatsoever, and the Railway Company and the Trustees shall not be affected by any notice to the contrary.

3. Except as where otherwise indicated, the term "Trustee," or "Trustees," or any other equivalent term as used in this Indenture,



shall be held and construed to mean the Trustee or Trustees for the time being under this Indenture, whether original or successor. Except when otherwise indicated, the term "Trustee Company" as used in this Indenture shall be held to mean The New York Trust Company, or any Trust Company which for the time being shall be a Trustee hereunder in succession to said The New York Trust Company. Whenever in this Indenture the term "Refunding and Improvement Bonds" is used, the same shall be deemed and construed to mean Improvement Bonds of the Railway Company, issued under these presents at the time outstanding and unpaid, unless the context requires some other meaning, and in like manner the term "coupons" shall be deemed and construed to mean the coupons belonging to the said outstanding coupon bonds, and in like manner the term "bondholders" shall be deemed and construed to mean the holders for the time being of the said outstanding bonds.

The headings of the articles are not a part of these presents, and shall not be regarded in determining any question relating to the construction or interpretation of any of the provisions hereof.

For convenience of recording this Indenture may be executed in several counterparts, each of which shall be deemed an original.

In Testimony Whereof, The Kansas City Southern Railway Company has caused these presents to be executed on its behalf by its President, or one of its Vice-Presidents, and its corporate seal to be hereto affixed, and attested by its Secretary, or its Assistant Secretary, and the due execution of these presents to be proved, and The New York Trust Company, in token of its acceptance of the trusts hereby created has caused these presents to be executed on its behalf by its President, or one of its Vice-Presidents and its corporate seal to be hereto affixed and attested by its Secretary or Assistant Secretary, and the due execution of these presents to be proved, and the said Edward F. Swinney has hereunto set his hand and seal in token of his acceptance of the trusts hereby created, as of the day and year first above written.

THE KANSAS CITY SOUTHERN RAILWAY  
COMPANY,

By J. S. SORENSON, *Vice-President*,

Attest:

[SEAL.] R. B. SPERRY, *Secretary*,

Signed, sealed, acknowledged and delivered on behalf of The Kansas City Southern Railway Company in the presence of us, who have hereto subscribed our names as witnesses in attestation thereof:

ALVIN UNTERMYER,

JESSE MYERS,

THE NEW YORK TRUST COMPANY,  
By F. J. HORNE, *Vice-President*,

Attest:

[SEAL.] H. W. MORSE, *Secretary*,

Signed, sealed and delivered on behalf of The New York Trust Company in the presence of us, who have hereto subscribed our names as witnesses in attestation thereof:

ALVIN UTERMYER,

JESSE MYERS,

[SEAL.]

EDWARD F. SWINNEY.

Signed, sealed and delivered by Edward F. Swinney in the presence of us, who have hereto subscribed our names as witnesses in attestation thereof.

ALVIN UTERMYER,

JESSE MYERS.

IN THE UNITED STATES OF AMERICA,

*Notary Public, New York County of New York, ss.*

On this 30th day of June, A. D. One thousand nine hundred and nine, before me, a Notary Public in and for New York County, State of New York, duly commissioned and acting, personally appeared John S. Sorenson, Vice-President of The Kansas City Southern Railway Company, to me personally known and known to me to be such Vice-President, and the same person who executed the foregoing instrument, who, being by me duly sworn according to law and say that he is the Vice-President of The Kansas City Southern Railway Company, and that the seal affixed to said instrument is the corporate seal of said The Kansas City Southern Railway Company, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and by him delivered as and for its act and deed. And he did further acknowledge said instrument to be the true act and deed of said corporation, and that he had executed the same as and for the said The Kansas City Southern Railway Company, for the consideration and purposes therein mentioned, and set forth, and I do hereby so certify.

My commission expires March 30, 1911.

In Testimony Whereof, I have hereunto set my hand and affixed my official seal the day and date above written.

[SEAL.]

JESSE MYERS.

*Notary Public, New York County.*

SS2. UNITED STATES OF AMERICA,

*State of New York, County of New York, ss.*

Before me, the undersigned authority, personally came and appeared John S. Sorenson, to me personally known, who being by me duly sworn, did say that he is the Vice-President of The Kansas City Southern Railway Company, a corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and acknowledged to me in the presence of the two subscribing legal wit-

nesses that he is Vice-President of said The Kansas City Southern Railway Company and that he had signed in the name of said Company and as such Vice-President the above and foregoing as the voluntary act and deed of said corporation and as his free voluntary act and deed as Vice-President thereof and for the uses and purposes therein set forth.

My commission will expire March 30, 1911.

In Faith Whereof, I have hereunto set my hand and seal of office this 30th day of June, 1909, at New York City, in New York County, New York.

[SEAL.]

JESSE MYERS,

*Notary Public within and for New York County.*

883 STATE OF NEW YORK,

*County of New York, ss:*

On this day personally appeared before the undersigned, a Notary Public within and for the County and State aforesaid, John S. Sorenson, to me well known as the Vice-President of The Kansas City Southern Railway Company, the grantor in the foregoing indenture, and acknowledged that he had, in his said official capacity, executed the foregoing instrument as the act and deed of said Company, for the consideration and purposes therein mentioned.

My commission will expire March 30, 1911.

Witness my hand and official seal this 30th day of June, 1909,

[SEAL.]

JESSE MYERS,

*Notary Public within and for New York County, New York.*

STATE OF NEW YORK,

*County of New York, ss:*

Before me, a Notary Public in and for said County and State, on this 30th day of June, 1909, personally appeared John S. Sorenson, to me known to be the identical person who subscribed the name of The Kansas City Southern Railway Company, the maker thereof, to the foregoing instrument as its Vice-President, and acknowledged to me that he executed the same as his free and voluntary act and deed and as the free and voluntary act and deed of such corporation for the uses and purposes therein set forth.

My commission will expire March 30, 1911.

Witness my hand and seal this 30th day of June, 1909,

[SEAL.]

JESSE MYERS,

*Notary Public, New York County.*

884 STATE OF NEW YORK,

*County of New York, ss:*

On this day personally appeared before the undersigned, a Notary Public, within and for the County and State aforesaid, R. B. Perry, to me well known as the Secretary of The Kansas City Southern Railway Company, and acknowledged that he had in his official

capacity executed the foregoing instrument as the act and deed of said Company for the consideration and purposes therein mentioned. My commission will expire March 30, 1911.

Witness my hand and official seal this 30th day of June, One thousand nine hundred and nine.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, N. Y.*

UNITED STATES OF AMERICA,

*State of New York, County of New York, ss:*

On this 30th day of June, A. D. 1909, before me, a Notary Public in and for the City and County of New York, State of New York, duly commissioned and acting, personally appeared Frederick J. Horne, Vice-President of The New York Trust Company, to me personally known and known to me to be such Vice-President, and the same person who executed the foregoing indenture, who, being by me duly sworn according to law, did say that he is the Vice-President of The New York Trust Company; that the said affixed to said instrument is the corporate seal of said The New York Trust Company, and that said instrument was signed and sealed in behalf of said The New York Trust Company, by authority of its Board of Trustees and by him delivered as and for its act and deed. And he did further acknowledge said instrument to be the free act and deed of said corporation, and that he had executed the same as and for the said The New York Trust Company for the consideration and purposes therein mentioned and set forth. And I do hereby so certify.

My commission will expire March 30, 1911.

In Testimony Whereof, I have hereunto set my hand and affixed my notarial seal at my office in New York City, in said County of New York, State of New York, this 30th day of June, A. D. 1909.

[SEAL.]

JESSE MYERS,

*Notary Public, No. 156, New York County, N. Y.*

UNITED STATES OF AMERICA,

*State of New York, City and County of New York, ss:*

Before me, the undersigned authority, personally came and appeared Frederick J. Horne, to me personally known, who being by me duly sworn, did say that he is the Vice-President of The New York Trust Company, of New York, a corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Trustees, and acknowledged to me in the presence of the two subscribing legal witnesses that he is the Vice-President of said The New York Trust Company, and that he had signed in the name of said Company and as such Vice-President the above and foregoing as the voluntary act and deed of said corporation, and as his voluntary act and deed as

the Vice-President thereof, and for the uses and purposes therein set forth.

My commission will expire March 30, 1911.

In Faith Whereof, I have hereunto set my hand and affixed my notarial seal at my office in New York City in said County of New York, this 30th day of June, A. D. 1909.

[SEAL.]

JESSE MYERS,

*Notary Public, No. 156, New York County, N. Y.*

86 UNITED STATES OF AMERICA,

*State of New York, City and County of New York, ss:*

On this day personally appeared before the undersigned, a Notary Public within and for the County and State aforesaid, Frederick J. Horne, to me well known as the Vice-President of The New York Trust Company, of New York, and Herbert W. Morse, to me well known as the Secretary of said Company, and acknowledged that they had in their said official capacities executed the foregoing instrument as the act and deed of said Company for the consideration and purposes therein mentioned.

My Commission will expire March 30, 1911.

In Testimony Whereof, I have hereunto set my hand and affixed my notarial seal at my office in New York City, in said County of New York, State of New York, this 30th day of June, A. D. 1909.

[SEAL.]

JESSE MYERS,

*Notary Public (No. 156), New York County, N. Y.*

STATE OF NEW YORK,

*County of New York, ss:*

Before me, a Notary Public in and for said County and State, on this 30th day of June, 1909, personally appeared Frederick J. Horne, to me known to be the identical person who subscribed the name of The New York Trust Company, one of the grantees hereof to the foregoing instrument as its Vice-President, and acknowledged to me that he executed the same as his free and voluntary act and deed and as the free and voluntary act and deed of such corporation for the uses and purposes therein set forth.

My commission will expire March 30, 1911.

Witness my hand and seal this 30th day of June, 1909.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County.*

87 STATE OF NEW YORK,

*County of New York, ss:*

On this 30th day of June, 1909, before me, Jesse Myers, a Notary Public in and for said county, personally appeared Edward F. Swiney, to me known to be the identical person described in and who executed the foregoing instrument, and acknowledged that he executed the same as his free and voluntary act and deed.

My term expires March 30, 1911.

In Witness Whereof, I have hereunto set my hand and affixed my official seal, at my office in the City of New York, in said County and State, the day and year first above written.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, State of New York.*

STATE OF NEW YORK,

*County of New York, ss:*

Be it remembered that on this 30th day of June, A. D. 1909, before me, the undersigned, a Notary Public, duly commissioned in and for the County and State aforesaid, came Edward F. Swinney, who is personally known to me to be the same person who executed the within instrument of writing, and he duly acknowledged the execution of the same.

In Witness Whereof, I have hereunto set my hand and affixed my notarial seal in New York City, New York County, New York, the day and year last above written.

My commission will expire March 30, 1911.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, New York.*

888 STATE OF NEW YORK,

*County of New York, ss:*

Be It Remembered, that on this day personally appeared before me a Notary Public in and for New York County, State of New York, Edward F. Swinney, to me well known as the grantee in the foregoing deed, and stated that he had executed the same for the consideration and purposes therein mentioned and set forth.

My commission will expire March 30, 1911.

Witness my hand and official seal as such Notary Public in and for New York County, State of New York, this 30th day of June, A. D. 1909,

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, New York.*

UNITED STATES OF AMERICA,

*State of New York, County of New York, ss:*

Before me, the undersigned authority, personally came and appeared Edward F. Swinney, to me personally known, who acknowledged to me in the presence of the two subscribing legal witnesses that he had signed the above and foregoing as his voluntary act and deed and for the uses and purposes therein set forth.

My commission will expire March 30, 1911.

In Faith Whereof, I have hereunto set my hand and seal of office this 30th day of June, A. D. 1909, at New York City, New York County, State of New York.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, New York.*

889 STATE OF NEW YORK,

*County of New York, ss:*

Before me, a Notary Public in and for New York County, New York, on this day personally appeared Edward F. Swinney, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

My commission will expire March 30, 1911.

Given under my hand and seal of office this 30th day of June, A. D., 1909.

[SEAL.]

JESSE MYERS,

*Notary Public, New York County, New York.*

890-893 United States Commerce Court. Filed Jan. 29, 1913.  
G. F. Snyder, Clerk.

Comp's Ex. 6. J. R. W.

P. 40 of original record of testimony.

The Kansas City Southern Railway Company.

I, G. C. Hand, Secretary of The Kansas City Southern Railway Company, do hereby certify that the annexed is a true and correct copy of a Report on the Proposed Revision of Grades and Alignment of the Main Line of The Kansas City Southern Railway, etc., made by Horace G. Burt in June, 1907, and of each and every part hereof.

[Corporate Seal of The Kansas City Southern Railway Company, Incorporated March 19, 1900.

G. C. HAND,

*Secretary, The Kansas City Southern Railway Co.*

New York, March 2, 1912.

UNITED STATES OF AMERICA.

*City, County and State of New York, ss:*

At New York, this second day of March, 1912, before me a Notary Public in and for the County of New York, personally appeared G. C. Hand, Secretary of The Kansas City Southern Railway Company, to me personally known and known to me to be the Secretary of The Kansas City Southern Railway Company and the person mentioned and described in and who acknowledged the foregoing certificate, and he duly acknowledged to me that he executed the same as Secretary of The Kansas City Southern Railway Company.

In witness whereof, I have hereunto affixed my name and notarial seal the day and year first above written.

[Seal Jesse Myers, Notary Public, New York County.]

JESSE MYERS,

*Notary Public, New York County, No. 144.*

My commission expires March 30th, 1913.

\* \* \* \* \*

894 & 895 Mr. L. E. Loree, Chairman Executive Committee, The K. C. S. Ry. Co., No. 25 Broad St., New York.

DEAR SIR: I beg to submit, herewith, Report on the matter of the revision of gradients and alignment of The Kansas City Southern Railway, the investigation of which subject was undertaken last August in accordance with an understanding had with you at New York in the month of July preceding. The objects of the investigation are:

#### Objects of Investigation.

First. The determination of such changes and revisions in the gradients and alignment of the Main Line of The Kansas City Southern Railway, Kansas City, Mo., to Port Arthur, Tex., as will provide for the future commercial and operating requirements of the railway in the most efficient and economical manner practicable, the estimated cost of such improvements, together with the amount of the justifiable expenditure therefor; and

Second. The determination by divisions or districts of those changes and revisions (included in paragraph first) that are now of the most importance and will give the largest immediate return in proportion to the outlay, together with the amount of such outlay and the justifiable expenditure required for such improvements.

#### Determining Physical Factors of Economy in Railway Operation.

The determining Physical Factors of Economy in the Operation of a Railway, like The Kansas City Southern, are the Ruling Gradient and the Relative Length of Line. The more important of these Factors, in the case of The Kansas City Southern Railway, is the one of Ruling Gradient, and its importance varies directly with the volume of freight traffic. In the building of most Western Railways, the question of economy of operation, even when appreciated at its full significance (which was rarely the case), had to be held secondary to the more pressing question of first cost of construction, which was a condition precedent to building at all; or if taken into account, it was not infrequently subordinated to the more easily obtained, as well as less costly requirement, of a Short Line (with heavy Ruling Gradient) between the initial and objective points. The case of The Kansas City Southern Railway furnishes no exception to this rule. It will not be understood, however, from what has been said, that little weight is attached to the "Short Line"



feature of The Kansas City Southern Railway; on the contrary, in view of the possibilities of Grade Reduction, and in connection therewith, that feature assumes an increased importance.

In the consideration of the matter of Grade Revision in any case, the first question is whether such Revision is absolutely essential to the future growth and welfare of the Railway; the second whether the expenditure required for such Revision is justifiable by the existing volume of traffic. The determination of proper answers to these questions involves a careful consideration and review of the business, present and prospective, of the Railway under consideration and frequently, as in the case of The Kansas City Southern Railway, exhaustive examinations and surveys for the purpose of determining the proper location and cost of the proposed improvements.

\* \* \* \* \*

896 The following Table shows for the calendar year 1906, the grain and grain products through the Ports of New Orleans, Galveston and Port Arthur—all the grain shown at the last named Port being handled by The Kansas City Southern Railway:

TABLE 2.

Port.	Barrels of flour.	Bushels of			Total.
		Wheat.	Corn.	Oats.	
Port Arthur.....		1,270,796	1,106,067		2,466,863
New Orleans.....	1,219,867	5,675,853	17,337,450	5,117,779	29,650,949
Galveston.....	404,121	11,111,165	9,517,871	100,911	21,133,168
Total.....					53,270,980

#### Transportation of Grain and Grain Products to Tide Water on Low Rates.

It is apparent from the above Table that there is room for expansion in the Export Traffic of The Kansas City Southern Railway, which would mean additional tonnage at very low rates, but, nevertheless profitable, because of the preponderance of south-bound empty car movement. When the traffic becomes Balanced, and it lacks less than an additional train to make it so, over the major portion of the Road—the question of Export Grain traffic will be a serious one, for the margin of profit, already too narrow, will be materially reduced, and with an increasing preponderance of south-bound traffic, wiped out entirely. It would be possible to make a calculation mounting almost to demonstration as to how this would happen, but when it is remembered that the existing margin between the rate received, about 3.2 mills per ton-mile and the cost of movement, .83 mills per ton-mile, is only .37 of a mill per ton-mile with preponderance of empty car mileage in a north-bound (favorable) direction, no such demonstration will appear to be necessary.

897-899 In conclusion, there is this to be said:—

First, The growth of traffic for many years to come

will largely be south-bound and made up principally of grain and grain products.

Second. The rates on this traffic are the lowest rates going, and with the introduction of inland water transportation, they are likely to be lower.

Third. The Kansas City Southern Railway cannot, on its present grades, with a preponderance of south-bound traffic, handle the export grain traffic with profit.

Fourth. With Grades reduced to the basis of 0.5 per cent, the present expense movement, 2.83 mills per revenue ton-mile of The Kansas City Southern Railway, can at least be cut in half and the Road be placed in a position to handle the lowest classes of traffic offering, at a profit.

\* \* \* \* \*

9900 Before entering upon the investigation of the matter of Grade Revision it will be well, for the benefit of those who do not care to go into the details of the investigation, to present briefly the Conclusions reached therefrom. They are as follows:

9901

#### *Conclusions.*

Two Lines of Revision, the "Preferred" and "Ultimate,"

The investigation of the matter of The Revision of Grades and Alignment of The Kansas City Southern Railway results in the determination of two Lines of Revision supplementing each other and which, in the order of their present importance and preference, are designated the line of "Preferred Revision" and the Line of "Ultimate Revision"; and the adoption of a Ruling Gradient of 0.5 per cent (26.4 feet to the mile), as the one calculated to give the best results in cost of Revision and in the future operation of the Railway:

First, the Line of "Preferred Revision": Grade Revision Justified.

(a) The Line of "Preferred Revision" is shown on the attached Exhibits "A," "(A1)," "B," "C," "D," "E," "F," and "G" in Red Color. The length and cost of construction of the Revisions and Changes of Operated Road and the New Line which are embraced in said Line are given in the attached Exhibits 1, 2, 3, and 4, and are shown by the Operating Districts of the Railway in the following statement:

## Line of "Preferred Revision" by Operating Districts.

## Statement of Line of "Preferred Revision" by Operating Districts.

Kansas City—Pittsburg .....	Lines 8 to 80, incl., Exhibit 1,1		
Revisions of Line.....	20.50 miles	\$295,865.	Cost.
Changes " " .....	18.85 "	601,596.	"
Total.....	39.44 "	\$897,461.	"
Pittsburg—Stillwell (Stillwell Junction).....	Lines 2 to 7, incl., Exhibit 2,1		
	Lines 16 to 21, incl., Exhibit 2,1		
Revisions of Line.....	4.70 miles	\$75,820.	Cost.
Changes " " .....	54.43 "	1,780,505.	"
Total.....	59.13 "	\$1,856,325.	"
Stillwell (Stillwell Junction)—Mem.....	Lines 22 to 25, incl., Exhibit 2,1		
	Lines 57 to 60, incl., Exhibit 2,1		
Revisions of Line.....	20.77 miles	\$263,063.	Cost.
Changes " " .....	9.33 "	258,642.	"
New Line, (including Stillwell Connection 3.5 miles.) .....	44.29 "	1,847,305.	"
Total.....	74.39 "	\$2,369,010.	"
Mem—Shreveport.....	Lines 1 to 16, incl., Exhibit 3,1		
	Lines 1 to 17, incl., Exhibit 4,1		
Revisions of Line.....	19.40 miles	\$225,492.	Cost.
Changes " " .....	59.43 "	1,624,549.	"
Total.....	69.62 "	\$1,850,041.	"
Shreveport—Leesville.....	Lines 18 to 58, incl., Exhibit 4,1		
Revisions of Line.....	32.20 miles	\$358,625.	Cost.
Changes " " .....	23.49 "	751,831.	"
New Line.....	5.08 "	157,072.	"
Total.....	60.86 "	\$1,267,528.	"
Leesville—Port Arthur.....	Lines 59 to 80, incl., Exhibit 4,1		
Revisions of Line.....	14.18 miles	\$141,783.	Cost.
Changes " " .....	3.43 "	91,882.	"
Total.....	17.61 "	\$233,665.	"
Totals.....	320.75 miles	\$8,474,870.	Cost.

(b) The Reduction of the Grades of The Kansas City Southern Railway from the existing high Ruling Maximum Gradients of 4m 1.0 per cent to 1.63 per cent, to a Uniform Ruling Gradient of 0.5 per cent on the Line of "Preferred Revision" is justified as follows:

Total Estimated Cost of Grade Revision and Establishment of Main Line via Ft. Smith.

(Exclusive of change of Terminals as shown in note of Table 4 below.)

Revisions and Changes of Operated Road.....	\$6,444,677
Establishment of Main Line via Ft. Smith.....	2,030,193
Total .....	<u>\$8,474,870</u>

902

Interest on above cost, at 5% per annum.....	\$423,743
Estimated Gross Saving, per annum, from operation on reduced grade, with existing density of traffic.....	\$577,763
Estimated Net Saving, per Annum, from operation on reduced grade .....	154,020

(c) An analysis of the Line of "Preferred Revision" is shown by the following Table:

Grade Revision Justified on Line of "Preferred Revision."

TABLE 4.

*Line of "Preferred Revision."*

Length of Line, Total Estimated Cost of Construction and Annual Interest at 5 per cent per Annum on the same, and Comparative Results from Operation on the basis of 0.5 per cent Ruling Gradient. (See attached Exhibits "A", "A1)", "B", "C", "D", "E", "F", and "G", and 1, 2, 3, and 4.

Between—	Line.	Length of line in miles.	Increase or decrease in length.	Total cost of constr'n.	Interest on cost at 5% per annum.	Comp. results operation.	
						Total annual gain.	Net loss. Net gain.
Belt Junction—Pittsburg.....	"(A1)"	118.28	Inc. .38	\$897,461	\$44,873	\$86,288	..... \$41,415
Pittsburg—Stillwell Junction.....	"(A2)"	131.05	" 1.94	\$1,856,325	92,816	149,475	..... 56,659
Stillwell Junction—Spiro.....	"(A1)"	56.94	" 3.76	2,030,193	101,510	114,088	..... 12,578
Spiro—Mena.....	"(A1)"	68.46	" .29	339,657	16,983	48,079	..... 31,696
Mena—De Queen.....	"(A1)"	57.51	" 3.62	1,410,526	70,326	54,150	..... \$16,376
De Queen—Shreveport.....	"(A1)"	125.98	" 1.21	439,515	21,976	41,545	..... 19,569
Shreveport—Leesville.....	"(A1)"	109.96	" .61	1,267,528	63,373	43,047	..... 20,329
Leesville—Port Arthur.....	"(A1)"	117.36	Dec. .23	233,665	11,683	41,061	..... 29,408
Belt Junction—Port Arthur.....	.....	758.54	Inc. 10.92	\$8,474,870	\$423,743	\$577,763	..... \$154,020

NOTE: To the above total cost should be added \$225,000 for changing Terminals, Pittsburg to Joplin, Mena to De Queen, and Horrocks to Leesville; the change from Stillwell to Fort Smith, \$100,000, is already included therein.

(d) By substituting in Table 4 above, Line "(A4)" between Pittsburg and Stilwell, in place of Line "(A2)," the following Table is obtained, showing the effect of using Mallet Road Engines between Neosho and Stilwell and Regular Road Engines on Line of "Preferred Revision" "(A1)," between Stilwell and Spiro, via Stilwell Junction and Fort Smith:

Use of Mallet Road Engines Between Neosho and Stilwell.

TABLE 5.

*Line of "Preferred Revision," Modified by Scheme "(A4)"; Use of Mallet Road Locomotive Between Neosho and Stilwell.*

Length of Line, Total Estimated Cost of Construction and Annual Interest at 5 per cent per Annum on the same, and Comparative Results from Operation on the basis of 0.5 per cent Ruling Gradient. (See attached Exhibits "A", "(A1)", "B", "C", "D", "E", "F", "G", and "H", and 1, 2, 3, and 4.

Between—	Line.	Length of line in miles.	Increase or decrease in length, Inc.	Total cost of construction.	Interest on cost at 5% per annum.	Comparative results operation.		
						Total annual gain.	Net loss.	Net gain.
Belt Junction—Pittsburg.....	"(A1)"	118.28	Inc. .38	\$897,461	\$44,873	\$86,298	.....	\$41,415
Pittsburg—Stilwell Junction.....	"(A4)"	132.66	" 3.55	278,842	13,942	101,655	.....	90,713
Stilwell Junction—Spiro.....	"(A1)"	56.94	" 3.70	2,630,193	101,510	114,988	.....	12,578
Spiro—Mena.....	"(A1)"	68.46	" .29	339,657	16,983	48,079	.....	31,906
Mena—De Queen.....	"(A1)"	57.51	" 3.62	1,410,526	70,526	51,150	\$16,376	.....
De Queen—Shreveport.....	"(A1)"	125.98	" 4.21	439,517	21,976	41,545	.....	19,569
Shreveport—Leesville.....	"(A1)"	109.96	" .01	1,297,528	63,376	43,047	20,329	.....
Leesville—Port Arthur.....	"(A1)"	117.36	Dec. .23	223,965	11,583	41,091	.....	29,408
Belt Junction—Port Arthur.....	.....	787.45	Inc. 12.90	\$6,807,387	\$344,839	\$532,943	.....	\$188,071

NOTE: From the above total cost should be deducted \$100,000 for the Fort Smith Terminal—The Stilwell Terminal remaining unchanged, and to the above total cost should be added \$150,000, for changing Terminals from Pittsburg to Joplin and Hornbeck to Leesville—The Mena Terminal to remain as at present.

This Scheme shows a net saving, per annum, of \$188,074, but on reference to Table 24, page 65, of comparison of Schemes "(A1)," "(A2)," "(A3)," "(A4)," "(A5)," "(A6)," and "(A7)," between Pittsburg and Stilwell Junction and Stilwell, it will be seen that Line "(A4)" does not gain so rapidly as "(A2)," and would fall behind it in from two to three years; moreover, the expenses of the Intermediate Terminal at Neosho and the cost of breaking up trains at both Terminals would more than offset the advantage in saving. With this Scheme, the Terminal would remain at Stilwell, and the one at Mena would also remain unchanged.

903 (c) As a still further modification of the Line of "Preferred Revision," the use of Mallet Road Locomotives may be introduced between Mena and Horatio, as shown by Scheme "(A2)"—between Mena and Horatio—in the following Table 6:

Use of Mallet Road Engines Between Mena and Horatio.



TABLE C.

*Line of "Preferred Revision," Modified by Use of Milled Road Terminations; Scheme "A3" Between Voocho and Stilwell and in Scheme "A2" Between Mena and Horatio.*

Length of Line, Total Estimated Cost of Construction and Annual Interest at 5 per cent per Annum on the same, and Comparative Results from Operation on the basis of 0.5 per cent Rolling Gradient. (See attached Exhibits "A", "A1)", "B", "C", "D", "E", "F", and "G", and 1, 2, 3, and 4.

Between—	Line.	Length of line in miles.	Increase or decrease in length.	Cost of construction.	Interest on cost at 5% per annum.	Comp. results operation.		
						Total annual gain.	Net loss.	Net gain.
Belt Junction—Pittsburg.....	"(A1)"	118.25	Inc. .38	\$897,461	\$44,873	\$862,588	.....	\$41,415
Pittsburg—Stilwell Junction.....	"(A4)"	132.66	" 3.55	278,842	13,942	104,655	.....	90,713
Stilwell Junction—Spiro.....	"(A1)"	56.94	" 3.70	2,030,193	101,510	114,088	.....	12,578
Spiro—Mena.....	"(A1)"	68.46	" .29	333,657	16,983	48,079	.....	31,096
Mena—Horatio.....	"(A2)"	60.84	" 0.00	.....	.....	19,441	.....	19,441
Horatio—Shreveport.....	"(A2)"	117.82	" 0.00	190,096	9,505	58,889	.....	56,384
Shreveport—Leesville.....	"(A1)"	109.96	" .01	1,297,528	63,376	43,047	\$20,320	.....
Leesville—Port Arthur.....	"(A1)"	117.36	Dec. .23	233,055	11,683	41,091	.....	29,408
Belt Junction—Port Arthur.....	.....	787.15	Inc. 12.99	\$5,297,442	\$261,872	\$522,578	.....	\$260,766

NOTE: From the above total cost should be deducted \$100,000, for the Fort Smith Terminal—The Stilwell Terminal to remain unchanged, and added \$150,000 for changing Terminals from Pittsburg to Joplin and Hornbeck to Leesville—The Mena Terminal to remain unchanged.

The result of this modification, as shown by the above Table 6, is an apparent gain from Operation as compared with the Line of "Preferred Revision," but the result as shown is more apparent than real, as the Scheme would require the maintenance of an Intermediate Terminal and the breaking up of trains at each end of the Mallet Districts, the expense of which would more than offset the apparent savings from Operation.

### Second, the Line of "Ultimate Revision."

The Line of "Ultimate Revision" consists of the further Revision of the Grades of Operated Road, as will ultimately be required, say when the Gross Tonnage Movement of the Railway reaches twice or three times its existing Density. These proposed ultimate changes are particularly described in paragraphs (a) and (b), following, and are shown on attached exhibits "A," "A1," and "B" in Green Color.

#### First Work of "Ultimate Revision," Neosho to Gravette.

(a) The first work of "Ultimate Revision" that will be required by the growing traffic of the Railway is the Revision of Grades and Alignment between Neosho, Mo., and Gravette, Ind. T., a distance of 36 miles Operated Road. The present Ruling Maximum Grade of this Section is 1.5 per cent (really 1.75 per cent — account of uncompensated curvature, which, however, can be reduced at small cost to 1.5 per cent), and the cost of Grade Revision on the basis of 0.5 per cent, the Uniform Ruling Gradient adopted for the Railway throughout, is estimated at \$2,116,220.

So large an expenditure would be excessive in proportion to the existing Density of traffic, and in view of the cost of the Helper Service that would be required to move the same in train loads corresponding to an 1.5 per cent Grade, which cost is estimated at \$50,000 per annum. When, however, on account of the increased traffic, the cost of such Helper Service shall grow to \$105,811.00 the interest charge at 5 per cent per annum on the cost of Revision as above, such Revision will be justified and should be undertaken.

(b) The next work of "Ultimate Revision" that will probably be required to accommodate a largely increased volume of traffic will be an independent Line between Belt Junction and Mile Post 30.26, a distance of 18.88 miles in place of the joint use of the Frisco Road between Belt Junction and Grandview as at present; the estimated cost of such a Line is \$914,576.

#### 904 Second Work of "Ultimate Revision" Belt Junction to M. P. 30.26.

On the basis of the present volume of traffic, in view of the low rental (about \$5,000 per annum) paid the Frisco Company for joint use of its Road as above and the cost of Helper Service thereon re-

ed to move the traffic in uniform train loads corresponding to a per cent Gradient, which cost would probably not amount to e than \$15,000 per annum, the building of an independent Line or now justified. But with an increase of—say 125 per cent—in present volume of traffic, a corresponding increase in cost of per Service, and with the congestion of traffic that would ensue r the probable material increase of the traffic of the Frisco Com- the building of the independent Line with an 0.5 Ruling Gradient would no doubt be fully justified.

#### 0.5 Per Cent Lowest Practicable North of De Queen.

y North of De Queen the lowest practicable Gradient obtainable 5 per cent, but south of De Queen a 0.3 per cent Ruling Gradient be provided for an expenditure of \$1,948,576 over the cost of a per cent grade. The expenditure required for a 0.3 per cent ing Gradient south of De Queen, however, is not justified by the ing volume of traffic, nor will it be fully justified until the traffic y of the Railway shall require a Second Track for its proper minodation, in which case the Kansas City Southern Railway's sed Main Line, Kansas City to De Queen, embracing three Oper- g Districts, would have a 0.5 per cent Ruling Gradient, and from Queen to Port Arthur, also embracing three Operating Districts, d have a 0.3 per cent Ruling Gradient.

\* \* \* \* \*

#### d. Ruling Gradient. 0.5 Per Cent Best Adapted for Grade Revision.

) A Ruling Gradient of 0.5 per cent (26.4 feet per mile) is one best adapted to the Revision of Grades of The Kansas City hern Railway between Kansas City and Port Arthur.

) It is the lowest Ruling Gradient compatible with little or no ment Duplication of Operated Road: a 0.3 per cent Ruling Gradient, on the other hand, would require the permanent Duplica- of Operated Road most of the way from Kansas City to De n, Arkansas, a distance of about 133 miles.

#### Comparative Length of 0.5% and 0.3% Ruling Gradient.

) A Ruling Gradient of 0.5 per cent would only increase the h of Operated Road between Kansas City and De Queen, Ark.,

10.92 miles, or 2.52 per cent. The length of Line between the same points on a 0.3 per cent Ruling Gradient would be at least 10 miles greater or 12.93 per cent. Between De n and Port Arthur a 0.5 per cent Ruling Gradient would in- e the length of the Operated Road .99 mile, or .28 per cent. e a 0.3 per cent Ruling Gradient would increase the length 6.72 s, or 1.9 per cent.

## Comparative Cost 0.5% and 0.3% Ruling Gradient.

(d) The total estimated cost of "Preferred Revision" on the basis of a 0.5 per cent Ruling Gradient between Kansas City and De Queen is \$6,534,162, or at the rate of \$15,090 per mile of Operated Road. The cost of building a New Line on a 0.3 per cent Ruling Gradient between the same points would certainly not be less than \$35,000 per mile of Line, and probably would exceed \$40,000 per mile. From De Queen to Port Arthur, the cost of Revision on the basis of a 0.5 per cent Ruling Gradient would be \$1,940,708 or at the rate of \$5,513 per mile of Operated Road, and the cost of Revision on the basis of a 0.3 per cent Ruling Gradient \$3,886,264, or at the rate of \$11,009 per mile of Operated Road.

(e) The comparisons of paragraphs (c) and (d) between a Ruling Gradient of 0.5 per cent and one of 0.3 per cent may be tabulated as follows:

TABLE 8.

Ruling gradient.	Excess length miles.		Kansas City & De Queen.		De Queen & Port Arthur.		Total cost.
	Kansas City De Queen	De Queen Port Arthur.	Cost.	Cost per mile operated road.	Cost.	Cost per mile operated road.	
0.5%	10.92	0.99	\$6,534,162	\$15,000	\$1,940,708	\$25,498	\$8,474,870
0.3%	55.99	6.72	17,138,800	39,581	3,896,264	10,825	21,025,064

## 0.3% Ruling Gradient Not Justified by Existing Traffic.

(f) The total estimated cost of Ruling Gradient of 0.5 per cent as appears from the above Table 8, excluding cost of change of the three Terminals, Pittsburgh, Mena, and Hornbeck as above, is \$8,474,870, all of which expenditure is justified by the present volume of traffic. On the other hand, a Ruling Gradient of 0.3 per cent would cost \$21,025,064, of which \$17,138,800, representing the cost of the 0.3 per cent Line from Kansas City to De Queen, could not be justified by the traffic, and the balance, \$3,886,264 would require several years for its justification, and when justified, the 0.5 per cent Ruling Gradient could be reduced to a 0.3 per cent Gradient.

## Placing Ft. Smith on Main Line.

(g) A Ruling Gradient of 0.5 per cent will permit of placing Fort Smith on the Revised Main Line of The Kansas City Southern Railway, which is altogether impracticable with a Ruling Gradient of 0.3 per cent.

## Practicable Size of Average Train.

(h) A Ruling Gradient of 0.5 per cent, with an average loading of 25 tons to the car, an average weight of car of 20 tons, and with an average train content of empty cars, will permit of handling from 50 to 65 cars per train, which is a practical every-day limit to the size of the average train for a Western Single-Track Railway.

## Momentum Grades.

The 0.5 per cent Ruling Gradient adopted for the purpose of this investigation is supplemented, wherever practicable, by Train Momentum due to velocities ranging from 10 to 30 miles per hour, according to the physical conditions of the Line. While the writer is inclined to the use of Straight Grades, certainly wherever the lay of the ground and density of traffic both combine to justify it, he favors the use of Momentum Grades where otherwise Grade Revision might be impracticable or indefinitely delayed.

## Average Speed of Freight Trains.

The Grades as laid for the proposed Revision of The Kansas City Southern Railway will permit of an average speed of from 15 to 18 miles per hour for through freight trains with full loading with a maximum and minimum speed of 30 and 10 miles per hour respectively, at the bottom and top of Ruling Gradients.

The foregoing Conclusions are Recapitulated as follows:

*Recapitulation.*

## Grade Revision Justified on Line of "Preferred Revision."

First, The Revision of Grades and Alignment of The Kansas City Southern Railway on the Line of "Preferred Revision" is fully justified as follows:

Total Estimated Cost of Grade Revision and Establishment of Main Line via Ft. Smith (Exclusive of change of Terminals as shown in note to Table 4 above):

Revisions and Changes of Operated Road.	\$6,444,677
Establishment of Main Line via Ft. Smith.	2,030,193

Total.....	\$8,474,870
------------	-------------

Interest on above cost at 5 per cent per annum.....	\$423,743
Estimated Gross Saving, per annum, from operation on reduced grade, with existing density of traffic.....	\$577,763
Estimated Net Saving, per annum, from operation on reduced grade .....	\$154,020

0.5% Ruling Gradient One Best Adapted for Grade Revision.

Second, The Ruling Gradient of 0.5 per cent is the one best adapted for Grade Revision of the Main Line of The Kansas City Southern Railway. A Ruling Gradient of 0.3 per cent is impracticable between Kansas City, Mo., and De Queen, Ark., by reason of Excess Length and Duplication of Line. South of De Queen a 0.3 per cent Ruling Gradient is practicable, but is not justified by the existing volume of traffic, nor will it be fully justified until the traffic Density of the Railway shall require a Second Track for its proper accommodation.

Importance of Prosecuting Grade Revision, Without Delay.

Third, The Grade Revision on the Line of "Preferred Revision" could be begun at once and diligently prosecuted in order that The Kansas City Southern Railway may fortify itself as against the aggressive development of its powerful neighbors and competitors and in order that it may be able to handle at a profit the great volume of agricultural products offering at Kansas City and may rapidly develop its coal and other low grade tonnage resources.

Fourth, The commanding position and rapid growth of Fort Smith, Ark., make it essential that The Kansas City Southern Railway establish its Main Line through Fort Smith, and also locate its Division Terminals in that city, and this is a matter of such prime importance that it should be given immediate attention.

The Discussion of Grade Revision together with the Statistics and

Comparisons upon which the above Conclusions are based are found in the body of this Report, following.

Respectfully submitted,

HORACE G. BURT,

Chicago, Ill., June 25, 1907.

907 *Discussion of Proposed Revision of Grades and Alignment  
of The Kansas City Southern Railway.*

### Object of Grade Revision.

The object of grade revision is to effect a reduction in the cost of Railway Operation by increasing the Train Load and correspondingly decreasing the number of trains required to move a given traffic. The same results, within certain limits, may be obtained by an increase in the tractive power of the locomotives employed and when both means are employed together, the most effective results are obtained.

### Principal Factors of Grade Revision.

The adoption of any Scheme of Grade Revision is dependent upon several Factors, the most important of which are—First, the physical characteristics of the territory to be traversed; Second, the density of traffic to be moved; the former as affecting the practicability and cost of Revision, the latter as furnishing the justification therefor. It would perhaps be more suitable to reverse the order of these Factors, for with a Density of Traffic sufficiently large, physical obstacles may generally be largely overcome. Both of the above Factors in the case of The Kansas City Southern Railway are known, the latter being derived from traffic statistics of the Railway Company, the former having been ascertained by examinations and instrumental surveys of the territory made during the past year.

### Economic Basis of Grade Revision.

The economic basis of Grade Revision is the increased train load which results in a saving of train miles; but Grade Revision frequently involves Changes and Duplication of Line which materially affect the relative length of Road to be operated and to that extent the net saving of Train Miles, and in such cases, Curvature and Rise and Fall, which count in the net results of Revision, are also affected. In order, therefore, to determine the net results of Grade Revision, the several elements of Cost which enter into and affect it must be determined, and to these elements must be assigned proper values, "per Train Mile," or "per Train" and "per Mile of Road," etc., per annum.

### Units of Cost of Grade Revision.

The Operating Expenses of a Railway are usually divided into two classes—viz: Fixed and Movement Expenses, terms which are suffi-



ly self-explanatory. The Movement Expenses, with which Grade Division is principally concerned, are sub-divided into "Freight" and "Passenger," and these again are still further sub-divided into several classes corresponding with the different departments of Railway Operation and Maintenance. The Unit of Measure for Movement Expenses is the "Train Mile," and the several Units of Cost are determined thereby. (A) The following Table gives the Units of Cost "per Train Mile," of The Kansas City Southern Railway, based on statistics of actual Operation and Maintenance:

### Total Specific Cost per Train Mile.

TABLE 9.

*Units of Cost per Train Mile and per Mile of Road of the Kansas City Southern Railway, Based on Statistics of Actual Operation for the Year Ending March 1, 1907.*

Movement expenses.	Cost, cents per train mile.			
	Northern Division.		Southern Division.	
	Freight.	Pass.	Freight.	Pass.
Station Service.....	2.84	.35	3.65	.38
Yard ".....	4.32	.....	5.11	.....
Fuel for Locomotives—Switch	2.42	.....	2.60	.....
Fuel for Locomotives—Road	18.51	8.25	17.59	8.30
Train Service.....	11.41	10.07	11.41	10.58
Engine " (Except fuel)...	16.40	9.22	14.99	8.50
Wear and Tear of Road.....	5.78	4.48	9.41	7.58
" " " " Equipment	21.64	13.82	17.74	10.69
Accidental Expenses.....	7.18	4.63	8.30	4.26
Total Specific Cost per "Train Mile".....	cts. 90.50	cts. 50.82	cts. 90.80	cts. 50.29

The above (A), Cost per "Train Mile," is applicable to service "on" important Changes and Duplications of Line, which involve new stations and business; and also to the total abandonment of service on any Line of like extent or importance.

### Limited Specific Cost per Train Mile.

Fuel for Locomotives—Road.	18.51	8.25	17.59	8.30
Train Service.....	11.41	10.07	11.41	10.58
Engine Service—(Except fuel)	16.40	9.22	14.99	8.50
Wear and Tear of Road.....	5.78	4.48	9.41	7.58
" " " " Equipment.	21.64	13.82	17.74	10.69
Accidental Expenses.....	7.18	4.63	8.30	4.26
Limited Specific Cost per "Train Mile".....	cts. 80.92	cts. 50.47	cts. 79.44	cts. 49.41

## Cost per Freight Train Mile Saved by Reduced Grade.

The above (B), Cost per "Train Mile," is applicable to important Changes and to Revisions, of Line, involving no additional Station Service or business; and also to the transfer of a train from one Line to another, in cases where the Station Service, Yard Service or Fuel for Locomotives (Switch), on the Line transferred from, are not affected by such transfer; but when such items are affected by transfer, allowance should be made therefor.

Fuel for Locomotives—Road, . . . .	50% Total cts.	9.26	...	8.79
Train Service, . . . .	100% " "	11.41	...	11.41
(C) Engine " (Except Fuel), . . . . .	100% " "	16.40	...	14.99
Wear and Tear of Road, . . . . .	50% " "	2.89	...	4.71
Wear and Tear of Equipment, . . . .	50% " "	10.82	...	8.87
Accidental Expenses, 50%	" "	3.59	...	4.15
Specific Cost per "Train Mile" saved by Reduction of Grades, . . . . cts, 54.37 . . . . cts, 52.92				

The above (C), Cost per "Train Mile," is applicable to the Train Miles saved as a result of Grade Reduction.

## Cost per Freight Train Mile Saved by Increased Tractive Power.

(D) Train Service, . . . .	100% Total cts.	11.41	...	11.41
Engine " " " " " " " " " " " "	100% " "	16.40	...	14.99
Specific Cost per "Train Mile" saved by Increased Tractive power, cts, cts, 27.81 . . . . cts, 26.40				

The above (D), Cost per "Train Mile," is applicable to the Train Miles saved by using increased tractive power.

## Natural Deterioration of Road per Mile.

(E) Natural Deterioration per Annum, per Mile of Road \$600.00.

The above (E), Cost per "Mile of Road," is applicable in any case of increase or decrease in length of Revised Lines and to any Duplication of Line.

## Taxes of Road per Mile.

(F) Taxes per Annum per "Mile of Road"—\$250.00.

The above (F), Cost per "Mile of Road," is applicable in any case of increase or decrease in length of Revised Lines and to any Duplication of Line.

## Curvature and Rise and Fall.

## Curvature:

- (6) The elimination of Curvature, per daily train one way represents a saving per degree per annum of ..... \$ .20

## Rise &amp; Fall:

- (11) The elimination of Rise and Fall on grades below 1.0 per cent, per daily train one way, represents a saving per foot per annum of ... \$1.00  
and on grades from 1.0 per cent to 1.75 per cent, inclusive, per foot per annum of ..... \$1.25

## Specifications of Construction.

*Specification, Classification and Units of Cost for Grade Revision.*

File and Frame Trestles and Timber Culverts,

K. C. S. Standard.

Masonry for Bridges and Culverts,

Union Pacific Standard.

Metal Trusses,

Coopers "E-50" Strength.

Landbed Sections,

Earth Excavation, Slopes 1 to 1 ..... 24 ft. base,

Rock " "  $1\frac{1}{2}$  to 1 ..... 20 ft. "

Embankment "  $1\frac{1}{2}$  to 1:

15 feet and under in height ..... 18 ft. "

16 " and over " " ..... 20 ft. "

Wilton to Port Arthur, All Embankment ..... 20 ft. "

10% Added for Shrinkage.

Prices of Construction. TABLE 10.

Classification of Work and Units of Cost of Construction for Grade Revision—The Kansas City Southern Railway—Kansas City to Port Arthur.

Classification of work.	Per	Acres	Units of cost.		
			Units of cost.		
			Kansas City to Pittsburg.	Pittsburg to Wilton.	Wilton to Port Arthur.
			\$ Val.	\$ Val.	Revisions.
Right of Way.....					
Clearing.....	station		820,000	88,000	88,000
Grubbing.....	"		8,000	8,000	8,000
Earth Excavation.....	"		8,000	8,000	8,000
Loose Rock.....	Cu. Yd.		.17	.20	.25
Solid.....	"		.35	.40	.40
Overhaul after 500 feet.....	"		.35	.30	.80
Bridge Masonry.....	100 ft.		.01		
Culvert.....	Cu. Yd.		8,000	8,000	6,500
Bridge Timber.....	"		8,000	8,000	6,500
Culvert.....	M Ft. RM		40,000	20,000	6,000
Bridge Iron.....	"		40,000	20,000	7,000
Metal Trusses.....	Lb.		.04		
Metal Girders.....	"		.04		
Piling.....	Lin. Ft.		.025	.025	.045
Iron Culv. Pipe 24" (Main Line).....	"		.50		
" " 24" (Detour).....	"		.50		
" " 36" (Main Line).....	"		3.25	3.25	5.00
" " 36" (Detour).....	"		8.75		8.75
" " 48" (Main Line).....	"		9.25	9.25	
" " 48" (Detour).....	"		14.25		14.25
Tunneling.....	"		15.00		
Main Track (New Including Ballast).....	Mile		125,000	15,000	
" (Second Hand).....	"		100,000	100,000	100,000
Side " (New) Per Mile of Main Line.....	"		50,000	50,000	50,000
" (Second Hand) Per Mile of Main Line.....	"		100,000	100,000	100,000
Buildings, Fences, Road Crossings, etc.....	"		500,000	500,000	500,000
Ballast (Alone).....	"		100,000	100,000	100,000
(a) Trestle bridging has been estimated from \$7.00 per linear foot on average height bridges on Revision to \$10.00 for high bridges on Changes of Lane.	"		200,000	200,000	200,000
(b) Trestle bridging has been estimated from \$7.00 per linear foot on average height bridges on Revision to \$10.00 for high bridges on Changes of Lane.	"		200,000	200,000	200,000

*Volume, Character, and Distribution of Traffic.*

The traffic of The Kansas City Southern Railway consists of two classes of freight, viz.—Revenue and Non-revenue or Company. These two classes constitute the Net Tonnage, the volume of which is given in the Annual Statistics of the Railway is shown in Table 11 below for five years ending June, 30th, 1906.

TABLE 11.

*Comparative Statement of Net Tonnage, The Kansas City Southern Railway, Five Years Ending June 30th, 1906.*

Tonnage.	1902.	1903.	1904.	1905.	1906.	Per cent Inc. or Dec. compared with year 1901.					Av. Incr. per yr.
	Tons.	Tons.	Tons.	Tons.	Tons.	1902.	1903.	1904.	1905.	1906.	
Revenue.....	2,038,843	2,198,646	2,320,127	2,320,811	2,776,747	10.32	18.97	25.55	33.81	50.03	10.05
Company.....	656,096	591,826	561,703	517,549	802,082	4.57	5.52	10.33	12.59	42.40	8.48
Total.....	2,694,939	2,790,472	2,881,830	2,838,360	3,578,829	8.91	12.47	16.46	22.06	48.27	9.66

## Per Cent of Increase, Five Years.

From the above Table it appears there was an increase of 48.27 per cent in Net Tonnage for the year 1906 as compared with the year 1901, due to 50.03 per cent increase in Revenue and 42.40 per cent in Company Freight. The average yearly increase in Net Tonnage for the five years was 9.66 per cent, due to 10.05 per cent increase in Revenue and 8.48 per cent in Company Freight. The amount and percentages of Revenue Tonnage, by classes of commodities, are shown in the following Table 12 for the five years ending June 30th, 1906.

TABLE 12.

*Classified Revenue Tonnage, The Kansas City Southern Railway, Five Years Ending June 30th, 1906.*

Products of—	Total tons.					Per cent.				
	1902.	1903.	1904.	1905.	1906.	1902.	1903.	1904.	1905.	1906.
Agriculture .....	374,860	395,920	355,413	358,384	477,023	18.34	17.97	15.33	14.90	17.22
Animals .....	37,448	43,455	58,374	49,046	54,794	1.84	1.97	2.51	1.98	1.98
Mines .....	404,976	516,635	487,109	604,394	516,864	19.87	23.50	21.00	24.44	18.61
Forests .....	926,661	931,017	1,009,524	1,119,334	1,255,314	45.46	42.35	47.39	45.27	45.20
Manufactures .....	181,732	179,835	167,012	176,044	271,260	8.94	8.18	7.19	7.12	9.75
Miscellaneous .....	113,127	132,426	152,665	165,612	200,943	5.55	6.03	6.58	6.70	7.24
Total .....	2,038,943	2,419,646	2,329,127	2,472,811	2,776,747	100.00	100.00	100.00	100.00	100.00

It is apparent from Table 12 that the growth of the total tonnage during the years given, has been comparatively uniform and steady. As compared with the year 1904 the average rates of increase for five years for the several classes are as follows:

Agriculture .....	8.25%
Animals .....	4.99%
Mines .....	4.92%
Forests .....	8.51%
Manufactures .....	40.79%
Miscellaneous .....	20.80%

The total average being 10.05 per cent as given in Table 11. For the year 1906 the comparison with the previous year and the year 1901 was as follows:

TABLE 13.

*Comparative Statement of Revenue Commodities for the Year 1906, as Compared with the Years 1905 and 1901.*

Commodities.	1906.	1905.	1901.	Percentage of inc. or dec. of 1906.	
				Over 1905.	Over 1901.
Agriculture .....	177,923	358,381	338,186	33.27	41.23
Animals .....	54,794	49,046	43,857	11.71	24.93
Mines .....	516,864	604,394	419,824	14.48	23.11
Forests .....	1,253,314	1,119,334	880,531	12.14	42.56
Manufactures .....	271,269	176,044	67,138	54.06	393.96
Miscellaneous .....	200,943	165,612	98,492	21.33	104.01
Total.....	2,776,747	2,472,811	1,848,028	12.29	50.03

From the foregoing analysis it appears:

First. That the Revenue Traffic of 1906 was 50.03 per cent heavier than in 1901.

Second. That the average growth of Revenue Traffic during the above five-year period was comparatively uniform, steady and at the rate of 10.05 per cent per annum, and the actual growth from 1905 to 1906, 12.29 per cent.

Third. That all classes of commodities, except products of mines, showed material growth in the year 1906 over the year 1905 and any previous year; products of animals fell a little below the level of the year 1904, while products of mines dropped back to near the level of the year 1903.

Now while it is impossible to predict with certainty what the future course of traffic on The Kansas City Southern Railway will be, it is reasonable to assume that the average rate of growth, which has obtained during the five years, 1901 to 1906, can under ordinary conditions be maintained; and that with materially enlarged and improved facilities and corresponding service the rate of growth from 1905 to 1906 is equally reasonable of assumption.

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### *Gross Tonnage.*

#### Gross Tonnage Governs Grade Revision.

In the working-out of Grade Revision the Net Tonnage needs to be supplemented by the weight of Equipment (freight cars) in which it is transported, in order to meet the actual conditions of operation. This combined tonnage is called the Gross Tonnage of the Railway. Table 14 below gives the Gross Tonnage as constituted during the years 1902 to 1906 inclusive:



TABLE 11.

Comparative Statement of Gross Tonnage, The Kansas City Southern Railway, Five Years Ending June 30th, 1906.

Tonnage.	1902.		1903.		1904.		1905.		1906.	
	Tons.	%	Tons.	%	Tons.	%	Tons.	%	Tons.	%
Revenue Tonnage.....	2,038,843	39.40	2,198,646	39.58	2,290,127	39.08	2,472,811	38.19	2,476,447	37.11
Company ".....	655,096	12.66	591,826	10.65	561,703	9.46	547,549	8.46	892,002	11.92
Equipment ".....	2,481,052	47.94	2,764,065	49.77	3,055,283	51.46	3,454,264	53.35	3,814,437	59.97
Total ".....	5,174,991	100.00	5,555,137	100.00	5,937,113	100.00	6,474,634	100.00	7,423,246	100.00

Per cent of Increase or Decrease Compared with the Year 1901.

Tonnage.	1901.		1902.		1903.		1904.		1905.		1906.	
	Tons.	%	Inc.	Dec.	Inc.	%	Inc.	Dec.	Inc.	%	Inc.	Dec.
Revenue .....	1,848,028	10.32	.....	.....	18.97	.....	27.55	.....	33.81	.....	50.03	.....
Company .....	626,437	4.57	.....	.....	.....	5.52	.....	10.33	.....	12.59	42.40	.....
Equipment .....	2,325,610	6.68	.....	.....	18.88	.....	31.28	.....	48.53	.....	64.02	.....
Total.....	4,800,075	7.81	.....	.....	15.73	.....	23.69	.....	34.88	.....	55.90	.....

Average Increase per year.

Revenue .....	10.05%
Company .....	8.48%
Equipment .....	12.80%
Total .....	11.18%

Equipment Tonnage 50.97 per Cent. of Total Tonnage, Year 1906

In the statement of Gross Tonnage above it will be noticed that Equipment Tonnage constitutes 50.97 per cent of the total in the year 1906, having declined from 53.35 per cent in 1905 and 51.14 per cent in 1904. The explanation of the high percentage of Equipment Tonnage lies for the most part in the excess of empty car mileage south-bound to provide for north-bound loading. This condition is clearly shown in Table 15 following:

TABLE 15.

*Comparative Statement of Loaded and Empty Freight Car Mileage, The Kansas City Southern Railway, Five Years Ending June 30th, 1906.*

Mileage of cars.	1902.		1903.		1904.		1905.		1906.	
	Car miles.	%	Car miles.	%	Car miles.	%	Car miles.	%	Car miles.	%
Loaded Cars North....	17,217,534	40.85	20,157,563	41.43	22,770,491	41.27	24,434,000	42.48	25,709,676	41.00
Empty " " " " " "	3,716,873	8.90	4,317,912	8.88	4,295,716	7.74	3,604,300	6.27	4,182,728	6.09
Total " " " " " "	20,934,407	49.67	24,475,475	50.31	27,072,297	49.05	28,038,300	48.75	29,892,404	47.09
Loaded Cars South....	15,132,230	35.25	15,769,652	32.48	15,569,637	28.21	14,614,295	25.40	20,357,359	32.33
Empty " " " " " "	6,119,637	14.50	8,417,131	17.21	12,519,392	22.74	14,867,812	25.85	12,324,022	19.09
Total " " " " " "	21,251,867	50.35	24,186,783	49.69	28,119,029	50.95	29,482,107	51.25	32,681,381	52.42
Total Cars N. & S.	42,215,674	100.00	48,662,258	100.00	55,191,326	100.00	57,520,407	100.00	62,573,785	100.00

The ideal condition would be a balance of loaded car mileage in both directions, but that is rarely obtained or long maintained in actual operation, especially where there is any decided growth in volume of one or more of the principal commodities transported, as grain, grain products, coal, lumber, etc. Another cause for the relative increase in Equipment Tonnage was the increase in the average weight of freight cars, amounting to approximately 14 per cent during the five years ending June 30th, 1906; the weight figures for The Kansas City Southern Railway is as follows:

912	1901.....	14.5	tons, average weight.
	1902.....	14.5	" " "
	1903.....	15.0	" " "
	1904.....	15.5	" " "
	1905.....	16.0	" " "
	1906.....	16.5	" " "

This average weight (and capacity) has increased in a greater ratio than either the load per loaded car or per loaded and empty car of Revenue and Company Freight as shown by the following Table.

TABLE 16.  
*Average Weight and Loading of Cars.*

Year.....	1901.	1902.	1903.	1904.	1905.	1906.	Av. inc. per year compared with 1901.
Tons to each loaded car Revenue and Com- pany Freight.....	20.46	20.53	20.51	21.04	20.61	21.56	1.07%
Tons to each loaded and empty car Revenue and Company Freight.....	14.89	15.45	15.14	14.62	13.99	15.87	1.31%
Tons weight of empty car.....	14.5	14.5	15.0	15.5	16.0	16.5	2.76%
Ratio of weight of car to load of loaded car..	70.87%	70.62%	73.13%	73.67%	77.03%	76.53%	1.59%
Ratio of weight of car to load of loaded and empty car.....	97.38%	92.00%	90.07%	105.02%	114.37%	103.97%	1.35%

It is not unlikely the average weight of freight cars will continue to increase at the same or an accelerated ratio up to an average of 20 tons, until the old small capacity equipment is worn out or becomes obsolete. In the matter of car loading, it is improbable that the average of loaded car loading, on account of mixed character of traffic, will increase in a much greater ratio than heretofore or rise much if any above 25 tons finally.

#### Distribution of Tonnage.

For the purpose of arriving at a basis of Gross Tonnage to be used in the working out of Grade Revisions we may take the Gross Tonnage movement of the Road for a period of three years, 1905 to 1907 inclusive (May and June of 1907 being estimated) and from the average rate of increase in the same, by the several Districts, estimate the Gross Tonnage movement for the year 1908 as follows:

an Estimate for the Year 1908.

	1905.		1906.		1907.		1908.	
	N. R.	S. R.	N. R.	S. R.	N. R.	S. R.	N. R.	S. R.
<b>Kansas City—Pittsburg.</b>								Estimated.
125.4 miles								
yearly	1,708,565	1,041,510	1,702,922	1,002,578	1,971,257	1,580,521		
(daily)	4681	2851	4402	2545	5101	4117		
(average)	3,778		4470		1874		5,127	
<b>Pittsburg—Stillwell.</b>								
120.2 miles								
yearly	1,448,320	1,020,005	1,520,501	1,052,471	1,675,208	1,554,551		
(daily)	3,968	2,797	4190	2705	4587	4065		
(average)	3,983		3118		1,125		1,040	
<b>Stillwell—Mena.</b>								
121.4 miles								
yearly	1,414,275	1,114,315	1,612,700	1,502,328	1,676,551	1,602,511		
(daily)	3,815	3,063	4416	4,262	4,503	4,303		
(average)	3,461		4,201		4,003		5,008	
<b>Mena—Shreveport.</b>								
178.1 miles								
yearly	1,306,295	1,145,370	1,423,730	1,421,217	1,440,812	1,431,970		
(daily)	3,576	3,178	3,901	3,894	3,917	3,931		
(average)	3,558		3,808		3,820		4,230	
<b>Shreveport—Hornbeck.</b>								
94.1 miles								
yearly	1,329,320	821,250	1,297,557	870,220	1,278,226	1,006,887		
(daily)	3,612	2,250	3,555	2,396	3,502	2,841		
(average)	2,946		2,971		3,172		3,285	
<b>Hornbeck—Port Arthur.</b>								
134.0 miles								
yearly	961,290	655,020	907,540	645,851	708,331	820,055		
(daily)	2,632	1,818	1,657	1,769	1,941	2,251		
(average)	1,220		1,503		2,120		2,580	
<b>Kansas City—Port Arthur.</b>								
782.2 miles								
yearly	1,271,561	943,781	1,072,981	1,204,565	1,456,831	1,750,286		
(daily)	3,484	2,596	3,762	3,382	3,989	4,719		
(average)	3,025		3,572		3,851		4,264	

913 It appears from the above Table that the Gross Tonnage movement while varying considerably in volume by divisions, Kansas City to Mena and Mena to Port Arthur, varies much less in volume north-bound and south-bound by Districts, the preponderance showing slightly north-bound. For the purposes of Grade Revision the tonnage movement is practically balanced as less than an average train-load would throw the balance of tonnage in either direction. There is no way of ascertaining definitely what the future course of the tonnage movement will be, but the probability is that the south-bound movement will gradually gain on the north-bound and in the end preponderate—perhaps largely.

Estimated Average Daily Tonnage for Year 1908 Assumed as Basis for Grade Revision.

The lumber movement which has furnished the preponderance of north-bound tonnage has probably reached its maximum, but the development of the country will supply other commodities to measurably take its place, perhaps on shorter hauls;—but as already stated the south-bound is likely in the end to preponderate. While this may be the case, the change in the movements will be gradual and the prospect hardly warrants an attempt at anticipating the future. The best plan is to take an average of the movements north-bound and south-bound and this has been done in the Table above the Estimated Average Daily Tonnage for the Year 1908 being assumed as the Basis for Grade Revision.

Physical Characteristics of the Main Line of The Kansas City Southern Railway and Adjacent Territory: Physical Characteristics, Estimated Cost of Construction, and Comparative Operating Results of Proposed Lines of Grade Revision.

The Main Line of The Kansas City Southern Railway, closely following the western boundary of the first tier of Trans-Mississippi States extends from the Missouri River at Kansas City to the Gulf of Mexico at Port Arthur, a distance of 786 miles. For a distance of 600 miles from Kansas City, it traverses the water-shed of the Mississippi River in the drainage areas of the Missouri, Arkansas and Red Rivers, leaving which, it crosses over into the valley of the Sabine River, thence into the valleys of the Calcasieu and the Houston Rivers, and back into the valley of the Sabine, which latter it follows to the Gulf. The Physical Characteristics of The Kansas City Southern Railway, corresponding generally with those of above drainage areas, are given in the following Table 18:



TABLE 18.

Physical Characteristics, Main Line, The Kansas City Southern Railway, Kansas City to Port Arthur.

District.	Length, miles.	Rdg. gradnt.		Curvature.			Rise and fall.	
		Rate.		Total degs.	Avg. deg. per mile.	°/ main line.	Feet.	Average per mile.
		South.	North.					
Kansas City—Pittsburg.....	129.2	1.00	1.00	2,894	22.4	29.0	1,797	13.9
Total.....	129.2	.....	.....	2,894	22.4	29.0	1,797	13.9
Pittsburg—Neosho.....	44.9	1.00	1.00	1,353	25.4	18.9	515	11.5
Neosho—Pay.....	59.4	1.61	1.50	3,062	51.6	35.7	1,174	19.8
Pay—Stillwell.....	24.9	1.00	1.00	785	31.5	24.8	374	15.0
Total.....	129.2	.....	.....	5,000	38.7	27.8	2,063	15.9
Stillwell—Heavener.....	59.6	1.00	1.00	2,493	31.3	22.5	1,017	12.8
Heavener—Mena.....	41.8	1.50	1.35	1,959	46.8	37.1	1,021	24.4
Total.....	121.4	.....	.....	4,452	36.6	27.6	2,038	16.8
Mena—Horatio.....	60.8	1.35	1.35	4,415	72.6	37.8	1,394	22.3
Horatio—Shreveport.....	117.8	1.00	1.00	1,605	14.8	15.0	1,155	9.8
Total.....	178.6	.....	.....	6,020	33.7	32.6	2,519	14.1
Shreveport—Hornbeck.....	93.5	1.00	1.00	2,103	22.5	17.3	1,054	11.3
Total.....	93.5	1.00	1.00	2,103	22.5	17.3	1,054	11.3
Hornbeck—De Ridder.....	57.1	1.00	1.00	409	28.3	21.9	527	14.2
De Ridder—Port Arthur.....	96.9	0.30	0.30	498	4.1	4.8	415	4.3
Total.....	154.0	.....	.....	1,517	11.6	9.5	912	7.0
Kansas City—Port Arthur.....	786.0	1.63	1.56	22,916	28.0	29.9	10,413	13.2

NOTE.—The following exceptions exist to the maxima of gradient and curvature given in the Table above:



1924 United States Commerce Court Filed Jan. 29, 1913 G. F. Snyder, Clerk. D.

RESPONSE TO EXHIBIT C. A. L. No. 8.

Accounting Series, Circular No. 11.

(Page 576 of Original Record.)

INTERSTATE COMMERCE COMMISSION,  
DIVISION OF STATISTICS AND ACCOUNTS,  
WASHINGTON, July 5, 1907.

DEAR SIR: On June 13 and 14, 1907, the Standing Committee on Corporate, Fiscal, and General Accounts of the Association of American Railway Accounting Officers met for the purpose of passing upon a tentative Classification of Additions and Betterments Expenditures. At this meeting the following resolution was adopted:

"Resolved, It is the sense of this Standing Committee that before this bulletin is submitted to the Interstate Commerce Commission that such members of the Association as desire to submit the same to their executive officers for any suggestions be permitted to do so and have their answers to the Chairman of this Committee, Mr. A. H. Plant, Comptroller, Southern Railway, Washington, D. C., before the 1st of July, 1907, and that the letters submitted to the Chairman of this Committee be transmitted to the Interstate Commerce Commission with the classification and text."

In accordance with the above resolution, it was not until July 1 that the Chairman of the Committee on Corporate, Fiscal, and General Accounts was authorized to submit to the Interstate Commerce Commission the tentative Classification adopted.

A cursory examination of this Classification, as also of the letters by which it was accompanied, leaves the impression that there are quite a number of principles involved that require further consideration before they can with propriety be promulgated under a formal order of the Commission. The importance of this Classification as an integral part of a system of operating accounts leads to the same conclusion. This being the case, it is thought wise to issue the Classification in the form of a circular, with the suggestion that for the present the general principles here laid down may be followed by accounting officers, but that no accounting officer should be required to make radical changes in past methods of accounting so far as the expenditures under consideration are concerned.

It should, however, be distinctly understood that the liberty thus granted must not be construed as authorizing that expenditures which are manifestly of the nature of additions and betterments may be charged to operating expenses; and in general it may be said that in case of conflict between the text of the classification here submitted and the instructions contained in the several classifications issued under order of the Commission, the instructions should govern.

In the reprint of this Classification of Additions and Betterment Expenditures, sufficient space has been provided under each primary account to allow for the insertion of criticisms or suggestions for further change. Accounting officers are earnestly requested to consider with care the principles underlying this Classification as also the text in which these principles are expressed and make replies accordingly. Such replies should be made in duplicate, one copy to be forwarded to Mr. C. G. Phillips, Secretary, Association of American Railway Accounting Officers, 143 Dearborn street, Chicago, Ill. and the other to the Division of Statistics and Accounts, Interstate Commerce Commission, Washington, D. C.

It is desired that replies to this circular be made not later than September 15, 1907.

Respectfully,

HENRY C. ADAMS,  
*In Charge of Statistics and Accounts.*

1025 *Tentative Classification of Additions and Betterments Expenditures, and Text Therefor.*

General Instructions.

For the purpose of making annual reports to the Interstate Commerce Commission, charges to the following accounts should be separated between "Additions" and "Betterments." "Additions" include additional structures, facilities, or equipment not taking the place of anything previously existing. "Betterments" include the enlargement or improvement of existing structures, facilities, or equipment, or the proper portion of the cost of new structures, facilities, or equipment of an improved or higher class taking the place of others previously existing.

In addition to reporting to the Interstate Commerce Commission each year the total expenditures for "Additions" and for "Betterments" in accordance with the following classification, carriers should also report the total expenditures for "Additions and Betterments," classified in accordance with the list of accounts provided for in the Classification of Expenditures for Road and Equipment.

The minimum charge to "Additions and Betterments" for building, bridge, or other structure or improvement thereto, or for any other individual piece of work, except as herein further provided, shall be \$200. Expenditures amounting to less than \$200, except as herein further provided, should be charged to the appropriate account under Operating Expenses or Outside Operations.

It is understood that the final assignment of the total of "Additions and Betterments" expenditures between Income, Capital, or Special Funds may be determined by the financial policy of individual carriers.

Credits to "Additions and Betterments" to cover the original cost (actual or estimated) of structures, facilities, or equipment removed, abandoned, or taken out of service and not replaced, should be assigned to income, capital, or special funds, in accordance with the

assignment of the original cost of such structures, facilities, or equipment.

NOTE.—The Classification of Expenditures for Road and Equipment applies exclusively to the construction and equipment of new main and branch lines and extension of existing lines.

#### Tentative Classification of Additions and Betterment Expenditures.

1. Right of Way and Station Grounds.
2. Real Estate.
3. Widening Cuts and Fills.
4. Protection of Banks.
5. Grade Revisions and Changes of Line.
6. Tunnel Improvements.
7. Bridges, Trestles, and Culverts.
8. Increased Weight of Rail.
9. Ballast.
10. Additional Main Tracks.
11. Sidings and Spur Tracks.
12. Terminal Yards.
13. Fencing Right of Way.
14. Improvement of Over and Under Grade Crossings.
15. Track Elevation, Elimination of Grade Crossings, etc.
16. Interlocking Apparatus.
17. Block and Other Signal Apparatus.
18. Telegraph and Telephone Lines.
19. Station Buildings and Fixtures.
20. Shops, Enginehouses, and Turntables.
21. Shop Machinery and Tools.
22. Water and Fuel Stations.
23. Grain Elevators and Storage Warehouses.
24. Dock and Wharf Property.
25. Electric Light and Power Plants.
26. Electric-Power Transmission.
27. Gas-Producing Plants.
28. Snow and Sand Fences and Snow Sheds.
29. Miscellaneous Structures.
30. Reconstruction of Road Purchased.
31. Steam Locomotives.
32. Electric Locomotives.
33. Passenger-Train Cars.
34. Freight-Train Cars.
35. Work Equipment.
36. Floating Equipment.
37. Interest, Discount, and Commission.

\* \* \* \* \*

1029

#### 5. Grade Revisions and Changes of Line.

To this account should be charged:

Grade Revisions.—Cost of reducing grades by cutting down summits and raising sags without materially changing the alinement.

The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels, and grading outfits, tools used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences, buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway crossing alarms, and watchhouses.

NOTE A.—The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; reballasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection; should all be charged to appropriate Operating Expense accounts.

NOTE B.—When, in reducing grades, grade crossings are eliminated and overhead crossings substituted therefor, the cost of grading the highway or street approaches to the new crossings, the overhead bridge with its abutments, piers, and posts, should all be charged to account, "Track Elevation, Elimination of Grade Crossings, etc." In case under crossings are substituted for grade crossings, the cost of the under crossing is a portion of the cost of the grade revision and should be charged to this account.

Changes of Alinement.—Cost of changing alinement for purposes of reducing curvature, cutting out bridges, tunnels, etc. The amount to be charged to this account for work of this description is the excess cost of the grading and bridging done, over the actual cost, or, if actual cost is unknown, estimated original cost of that portion of the grade, bridges, tunnels, etc., on the old line that will be abandoned or rendered unnecessary.

NOTE.—The explanations given under "Grade Revisions" as to the items constituting cost of grading, the portion of that cost and of the cost of track work of all kinds chargeable to Operating Expense accounts, and as to charging the cost of new overhead crossings, apply equally to "Changes of Alinement."

Changes of Line.—Cost of building new lines (exclusive of cost of right of way therefor, which should be charged to account, "Right of Way and Station Grounds") for the purpose of improving both grade and alinement, over the actual cost, if known, or estimated original cost, if actual cost is unknown, of the line to be abandoned. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs, switches, track fastenings, and other track material; ballast, track laying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovels, and other work equipment, locomotives, cars, and crews employed in the work.

NOTE A.—Cost of buildings, water and fuel stations, and similar structures on new lines, should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate Additions and Betterments and Operating Expense accounts, as provided for in the various accounts herein relating to the different classes of buildings and structures.

The actual or estimated original cost, as the case may be, of the buildings to be abandoned, exclusive of right of way and station grounds, of buildings as above, with the cost of removal of tracks, bridges, etc., less salvage, should be charged to the appropriate Operating Expense accounts.

31-1041 NOTE B.—All expenditures charged to account, "Grade Revisions and Changes of Line," should be classed as "Betterments."

\* \* \* \* \*

## 20. Shops, Enginehouses, and Turntables.

NOTE.—Expenditures charged to this account will be classed as "Additions" or "Betterments" according to the following definitions:

ADDITIONS.—To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); enginehouses (including turntables and cinder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and outhouses in connection with additional buildings; additional oil houses, sand houses, enginehouses for company's material, scrap bins, appurtenances, etc.; cinder pits, drop pits (outside of enginehouses), and turntables where none before existed. This account should include amounts when erected by contract; labor and material when built by company; preparing grounds before and clearing up same after completion; foundations and painting; excavation for and lining of additional turntable pits and of cinder or drop pits inside or outside additional enginehouses; foundations for additional turntables; lining, unloading, and placing turntables in position; levers, tracks, and stops for handling turntables; sewerage systems, connection with water supply system, and shop wells for additional buildings; architect's fees for drawing plans for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses, and cost of all tracks laid in any additional building above described, on transfer tables and turntables, in connection with such additional buildings and leading from such transfer tables or turntables into additional shops and enginehouses.

When shop buildings (with their appurtenances as above described), enginehouses, or turntables are removed and not replaced, the original cost thereof or, if original cost is unknown, their esti-

mated original cost should be credited to this account and charge less salvage, to the appropriate Operating Expense account, to which account should also be charged the cost of their removal and of restoring the grounds to proper condition, including filling foundations, wells, turntable pits, etc.

1043-1058 Betterments.—To this account should be charged the excess cost of new buildings to be used as shops, car sheds, or enginehouses, and of new transfer tables, turntables, cinder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for furnishing power or for heating and lighting existing shop buildings, enginehouses, etc., where such plants are not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, sidewalks, and outhouses in connection with existing shop buildings or enginehouses; excess cost of enlarging, altering, or rebuilding oil houses, sand houses, storehouses for company materials, scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing enginehouses where no pits previously existed; tractors or other apparatus for handling existing turntables; enlarging and deepening shop wells; excess cost of reconstructing water supply and sewerage systems for shops and enginehouses over cost of replacing the existing ones; cost of fence and hedges on or around existing shop grounds or buildings, where not previously fenced; all expenses incident to paving and draining existing shop grounds or grounds around existing shop buildings, enginehouses, etc.; and excess cost of extending, rearranging, or relaying tracks in shop buildings or enginehouses, on transfer tables or turntables in connection therewith, or of tracks leading from such transfer tables or turntables into shop buildings or enginehouses, over the cost of replacing the existing tracks.

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1069-1063 RESPONDENT'S EXHIBIT, C. A. L. No. 9.

(Page 626 of Original Record.)

Bulletin No. 33.

Association of American Railway Accounting Officers.

Standing Committee on Corporate, Fiscal, and General Accounts: A. H. Plant, Chairman; M. P. Blauvelt, S. B. Schuyler, C. I. Sturgis, S. J. Power, R. A. White, W. E. Bailey, R. I. Farrington, C. F. Krebs, G. N. Wilson, Erastus Young, H. A. Gray, W. J. Hobbs, S. C. Johnson, M. M. Kirkman, M. Riebenack, H. D. Bulkley, P. A. Hewitt, A. H. Plant, J. W. Renner, J. L. Cramer, Carlton Hillyer, S. M. Hudson, J. A. Taylor, T. J. Tobin, W. H. Williams.

OFFICE OF THE CHAIRMAN.  
WASHINGTON, D. C., July 15, 1908.

To Chief Accounting Officers, Members of the Association of American Railway Accounting Officers,

GENTLEMEN: At a meeting of the Standing Committee on Corporate, Fiscal and General Accounts held at Atlantic City, on July 4th, 7th, 8th and 9th, 1908, the following tentative Classification of Additions and Betterments Expenditures was formulated by that Committee and is hereby submitted to members in accordance with the following resolution adopted by the Committee:

Resolved: That the findings of the Committee on Corporate, Fiscal and General Accounts in connection with the uniform Balance Sheet, Additions and Betterments, and like questions be bulleted and submitted to Chief Accounting Officers, Members of the Association of American Railway Accounting Officers, for submission to their Chief Executive Officers, for such action as they may desire to take.

It is therefore requested that members submit this tentative Classification to their executive officers in accordance with the resolution quoted.

Should it be your desire or the desire of your Executives to transmit through the Chairman any communications to the Committee on Corporate Fiscal and General Accounts in respect to these matters, it will be my pleasure to receive them and to transmit them to the Committee.

Respectfully,

A. H. PLANT, *Chairman*.

\* \* \* \* \*

1064-1069 5. Grade Revisions and Changes of Line.

To this account should be charged:

Grade Revisions.—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment.

The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion such cost expenses of operating steam shovels and work in building temporary tracks for steam shovels, and grading out tools used in the work, etc.; raising or lowering existing bridges increasing length of culverts on account of increasing width of bankments, and replacing riprap at culvert ends; moving and locating telegraph or telephone poles and lines, block and signal systems, fences, buildings, etc.; changing grade crossings of farms, country roads or highways, and streets, including crossing gates, highway crossing alarms and watch houses.

NOTE.—The cost of such grading as is necessary to restore bank or cuts to original width, slope and grade should be charged to appropriate Operating Expense accounts.

Changes of Alignment.—Cost of changing alignment for purpose of reducing curvature, cutting out bridges, tunnels, etc.

Changes of Line.—Cost of building new lines, exclusive of cost of right of way therefor, which should be charged to account "Right of Way and Station Grounds," for the purpose of improving both grade and alignment. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs, and switches, track fastenings, and other track material; ballast, track-laying, and surfacing; fencing right of way crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovel and other work equipment, engines, cars, and crews employed in the work.

NOTE.—Cost of buildings, water and fuel stations and similar structures on new lines, should not be charged to this account, which is intended to cover the roadway and track only.

\* \* \* \* \*

#### 1070 20. Shops, Engine Houses and Turntables.

To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); engine houses (including turntables, cinder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and outhouses in connection with additional buildings; additional oil houses, sand houses, 1071-1077 storehouses for company's material, scrap bins, apparatus, etc.; also cinder pits, drop pits (outside of engine houses), and turntables where none before. This account should include amounts paid when erected by contract; labor and material when built by company; preparing grounds before and clearing same up after construction; foundations and painting excavation for and lining of additional turntable pits, and of cinder or drop pits inside or outside of additional engine houses; foundation

or additional turntables; loading, unloading and placing turntables in position; levers, tractors and stops for handling turntables; sewerage systems, connection with water supply system, and shop wells or additional buildings; architect's fees for drawing plans for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses, and cost of all tracks laid in any additional building above described, on transfer and turntables in connection with such additional buildings and leading from such transfer or turntables into additional shops and engine houses.

To it should also be charged the excess cost of new buildings to be used as shops, car sheds and engine houses, and of new transfer tables, turntables, cinder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for handling existing turntables, enlarging and deepening shop buildings, engine houses, etc., when such plants not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, sidewalks and outhouses in connection with existing shop buildings or engine houses; excess cost of enlarging, altering or rebuilding oil houses, sand houses, warehouses for company's materials scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing engine houses where no pits previously; tractors or other apparatus for handling existing turntables, enlarging and deepening shop buildings; excess cost of reconstructing water supply and sewerage systems for shops and engine houses over cost of replacing the existing; cost of fences and hedges on or around existing shop grounds or buildings, where not previously fenced; all expenses incident to grading and draining existing shop grounds or grounds around existing shop buildings, engine houses, etc.; and excess cost of extending, rearranging or relaying tracks in shop buildings or engine houses, on transfer or turntables in connection therewith, or of tracks leading from such transfer or turntables into shop buildings or engine houses, over the cost of replacing the existing tracks.

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1078

RESPONDENT'S EXHIBIT C. A. L. No. 11.

(Page 611, Original Record.)

Bulletin No. 36-C.

Association of American Railway Accounting Officers.

Standing Committee on Corporate, Fiscal and General Accounts  
 A. H. Plant, chairman; M. P. Blauvelt, S. B. Schuyler, C. I. Sturgis,  
 N. J. Power, R. A. White, W. E. Bailey, R. I. Farrington, C. E.  
 Krebs, G. N. Wilson, Erastus Young, H. A. Gray, W. J. Hobbs,  
 S. C. Johnson, M. M. Kirkman, M. Riebenack, H. D. Bulkley, P. A.  
 Hewitt, A. H. Plant, J. W. Renner, J. L. Cramer, Carlton Hillyer,  
 S. M. Hudson, J. A. Taylor, T. J. Tobin, W. H. Williams, C. G.  
 Phillips, secretary.

OFFICE OF THE CHAIRMAN,  
 WASHINGTON, D. C., April 19, 1909.

To Members of the Standing Committee on Corporate, Fiscal, and  
 General Accounts.

GENTLEMEN: I have just received from Mr. Adams his letter of  
 April 14th, enclosing certain typewritten sheets in regard to addi-  
 tions and betterments and the balance sheet prepared by him. I  
 understand a similar communication has been addressed to each  
 member of the committee, enclosing them copies of the documents  
 referred to therein. I deem it best, however, to bulletin these doc-  
 uments and to present them to the committee in advance of the meet-  
 ing of the association.

While I do not consider it necessary to call a meeting of the com-  
 mittee to consider this matter in advance of the association meeting,  
 I feel it would be of advantage to both the committee and the as-  
 sociation if an informal discussion could be had of these matters in  
 advance of the meeting, and I trust it will be possible for such a  
 conference to be held during the first day of the association meeting.

Respectfully,

A. H. PLANT, *Chairman.*

1079

INTERSTATE COMMERCE COMMISSION,  
 BUREAU OF STATISTICS AND ACCOUNTS,  
 WASHINGTON, D. C., April 14, 1909.

Mr. A. H. Plant, Comptroller, Southern Railway Company, Wash-  
 ington, D. C.

DEAR SIR: Since the meeting of the committee on corporate, fiscal  
 and general accounts, recently held at Buffalo, I have again gone  
 over the whole question of the additions and betterments classifica-  
 tion and the balance sheet with its accompanying text. Thinking  
 that you might be interested in the result of this final study, I send  
 you the accompanying documents.

Exhibit A. This exhibit contains, first, a revision of the general instructions which it is proposed should precede the classification of additions and betterments; and, second, a statement of the principles which have been followed in working out the details of that classification. I think you may learn from these concise statements, quite as well as from the text, the present condition of the classification of additions and betterments.

Exhibit B. This exhibit covers in detail all the changes which have been made in the balance sheet approved by the committee on corporate, fiscal and general accounts at Buffalo, and the reasons therefor. Some of these changes are matters of taste; others are rearrangements which on the whole seem to satisfy a larger number of balance sheet requirements, and some are required by certain general principles which seem essential to the commission.

Exhibit C. This exhibit is the modified balance sheet with the accompanying text. I feel that I should apologize for sending carbon copies. My chief reason for not having this matter printed for distribution is the danger that, in the hands of others than members of the committee of twenty-five, it might be regarded as the final and authoritative word upon this set of accounts. I have ventured to place this in your hands prior to the meeting of our association for such use as may seem wise to you under the circumstances.

Very truly yours,

HENRY C. ADAMS,  
*In Charge of Statistics and Accounts.*

Enclosures.

## EXHIBIT A.

### *Additions and Betterments.*

#### General instructions.

Additions and betterments include additional structures, facilities, equipment not taking the place of anything previously existing, the enlargement or improvement of existing structures, facilities, equipment, or the proper portion of the cost of new structures, facilities, or equipment of an improved or higher class taking the place of others previously existing.

Expenditures for additions and betterments should, at the end of each fiscal year, be reclassified in accordance with the primary accounts provided for in the classification of expenditures for road and equipment, it being understood that all expenditures for additions and betterments shall be charged to road and equipment.

Expenditures for additions and betterments amounting to less than \$200.00, except as herein further provided, should be charged to the appropriate operating expenses or outside operations account, except in case it becomes necessary directly in the course of betterment or improvement work, to abandon large and important pieces of property, the original cost, estimated if not known, of the property abandoned, should be credited against a corresponding proportion of the cost of the improvement and should be charged, less salvage, to

an account called "Property abandoned," to which should be charged the cost of removing the material and any other incidental expenses incurred in connection with its abandonment, in accordance with the text of the account "Property abandoned" in the classification of balance sheet accounts.

This classification applies exclusively to additions to, or betterments of, existing operating lines and the equipment thereof.

*Classification of Additions and Betterments Expenditures.*

1. Right of way and station grounds.
2. Real estate.
3. Widening cuts and fills.
4. Protection of banks.
5. Grade revisions and changes of line.
6. Tunnel improvements.
7. Bridges, trestles and culverts.
8. Increased weight of rail.
9. Ballast.
10. Additional main tracks.
11. Sidings and spur tracks.
12. Terminal yards.
13. Fencing right of way.
14. Improvement of over and under grade crossings.
15. Track elevation, elimination of grade crossings, etc.
16. Interlocking apparatus.
17. Block and other signal apparatus.
18. Telegraph and telephone lines.
19. Station buildings and fixtures.
20. Shops, engine houses and turntables.
21. Shop machinery and tools.
- 1081-1093 22. Water and fuel stations.
23. Grain elevators and storage warehouses.
24. Dock and wharf property.
25. Electric light and power plants.
26. Electric power transmission.
27. Gas-producing plants.
28. Snow and sand fences and snow sheds.
29. Miscellaneous structures.
30. Reconstruction of road purchased.
31. Equipment.
32. Interest and commission.

2. Explanation of additions and betterments.

An explanation of the classification of additions and betterments which it is proposed to adopt may be satisfactorily made by calling attention to the differences between this classification and the previous classification issued as accounting series circular No. 11. The changes are as follows:

First. The distinction between additions and betterments has been eliminated.

Second. Accounting series circular No. 11, provided that when any abandonment of property took place, whether such property was replaced by new and improved property or not, the cost of the property abandoned should be credited to additions and betterments and charged to operating expenses. The present classification retains this provision only in the case of property of minor importance or of minor value. When improved or costly pieces of property are abandoned in course of extensive betterment work, the cost of such property is to be credited against a corresponding proportion of the cost of the improvement and is to be charged to an account entitled "Property abandoned" which has been introduced in the balance sheet, with the intention that the cost of such property shall be redistributed to operating expenses over a period of from three to ten years. When such property is abandoned and not replaced, however, the additions and betterments accounts are not affected, for the reason that the classification of balance sheet accounts provides that the cost of such property shall be deducted directly from the account to which it was originally charged.

Third. Credits to accounts for old material removed or property abandoned have been introduced systematically on an original cost basis, the cost to be estimated if not known. This will be the occasion of several minor differences between the text of this classification and the text of accounting series circular No. 11. The changes are necessary in order that the property accounts may contain only the cost of property in the carrier's possession, a principle which has been kept in mind in compiling all the classifications which affect the property accounts.

Fourth. The several accounts for the various classes of equipment have been eliminated and one account substituted in their place. This, however, does not relieve carriers from the necessity of redistributing these accounts at the end of the fiscal year in accordance with the detailed equipment accounts contained in the classification of expenditures for road and equipment.

Fifth. While not affecting directly the classification of additions and betterments expenditures, it may be stated, in this connection, that inasmuch as the balance sheet provides that all additions and betterments are to be charged to the proper accounts under the caption "Property owned as investment," it will no longer be permissible to charge such improvements to income, profit and loss, or special funds created from income or surplus.

Sixth. The \$200.00 minimum for which provision was made in accounting series circular No. 11, is retained on the ground that to this extent additions and betterments may be charged directly to operating expenses as an offset to depreciation on property that can by no means be covered by formal depreciation charges. This is accepted as being in harmony with conservative management.

\* \* \* \* \*

## 1094-1102 18. Property Abandoned, Chargeable to Operating Expenses.

There shall be carried on the carrier's General Ledger an account entitled Property Abandoned.

Under this caption should be included:

a. Property Abandoned Through Additions and Betterments.

The original cost (estimated, if not known) less salvage, of important pieces of property, such as main line and sidings appurtenant thereto, including right of way and track material; station buildings and grounds; enginehouses, turntables and shop buildings and grounds thereof; terminal yards, including tracks, right of way buildings and other structures therein; old rails removed from track in the course of executing a general plan of relaying track with rail of heavier weight; bridges and trestles abandoned by reason of replacing them with bridges and trestles of greater capacity or more permanent nature; interlocking apparatus abandoned in course of elimination of grade crossings or other improvements; block and other signal apparatus replaced with apparatus of a different and improved type; fuel stations, grain elevators, storage warehouses, dock and wharf property, electric light and power plants and electric power transmission systems, gas producing plants, and all other important miscellaneous structures abandoned in course of replacing them with enlarged or improved property, including the cost of removing old material and all other incidental expenses directly in connection with the abandonment thereof.

NOTE A.—The cost of the above property should be credited to appropriate accounts under "Additions and Betterments."

NOTE B.—Charges to this account on account of property abandoned through Additions and Betterments should be redistributed to the carrier's Operating Expenses or Outside Operation Account in equal annual instalments during a period of not less than three years nor more than ten years from and including the year in which the property is abandoned. Carriers may, however, commence such charges in the year following the abandonment. The balance remaining in this section of the "Property Abandoned" Account at the close of the fiscal year appears on the balance sheet under the caption "Property Abandoned Chargeable to Operating Expenses."

b. Property Abandoned and Not Replaced.

The original cost (estimated, if not known) less salvage, of important pieces of property, such as those described in the preceding paragraph, which have been abandoned, but not in connection with improvements or betterments, including the cost of removing old material and all other incidental expenses directly in connection with the abandoned thereof.

NOTE A.—The cost of the above property should be credited to the amounts to which it was originally charged.

NOTE B.—Charges to this account on account of property abandoned not in connection with improvements or betterments should be redistributed to Profit and Loss at the end of the fiscal year.

\* \* \* \* \*



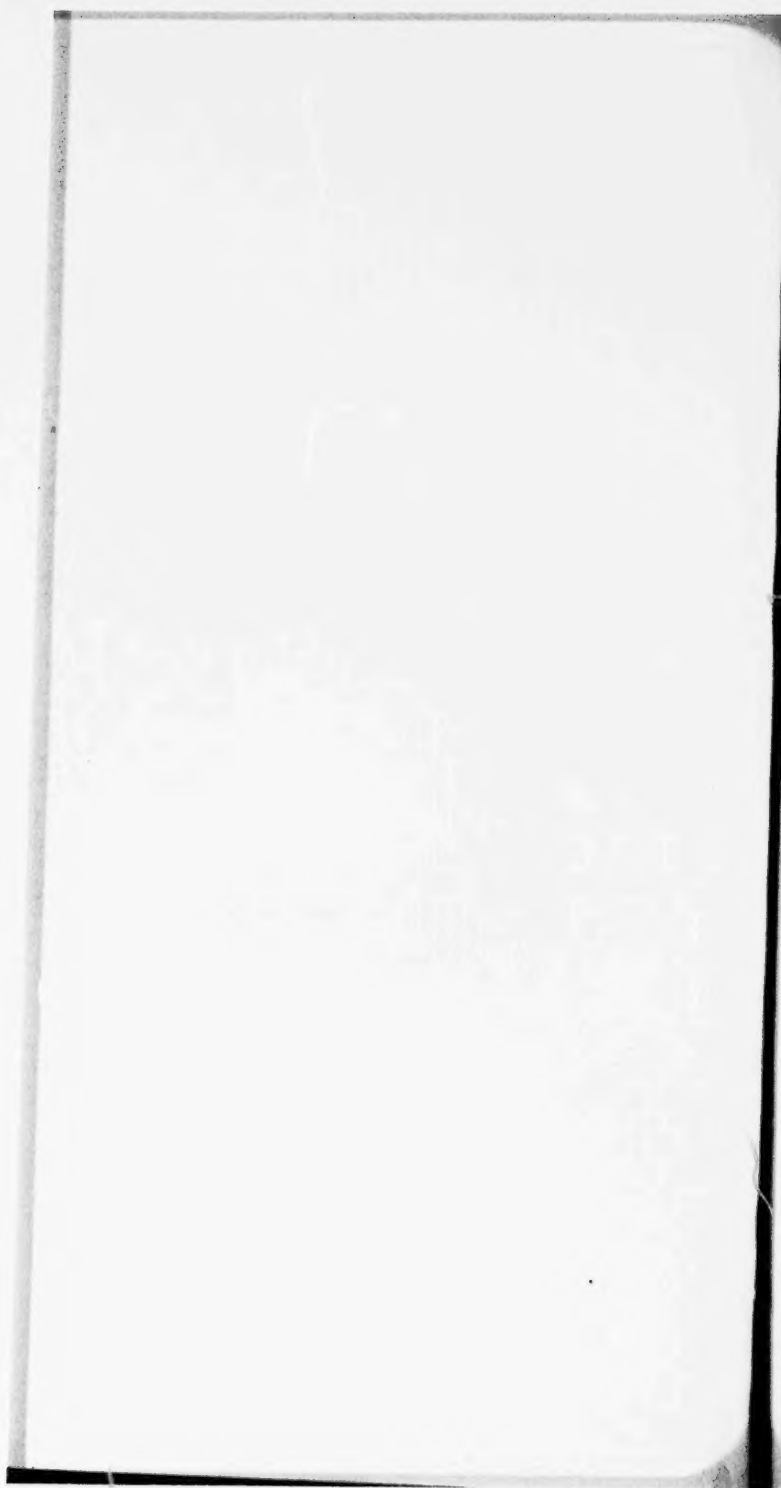
**CHARTS**

**TOO**

**LARGE**

**FOR**

**FILMING**



1157

*Journal Entries.*

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,  
 vs.  
 THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COM-  
 MERCE COMMISSION, Intervening Respondent.

Proceedings of March 11, 1913.

Said cause came on before the Court of final hearing upon the merits and the arguments of counsel were commenced. Mr. Arthur M. Wickwire appearing on behalf of the petitioner and Mr. Assistant Attorney General Denison on behalf of the United States.

Proceedings of March 12, 1913.

Said cause came on for further hearing upon the merits and the arguments of counsel were concluded. Mr. Assistant Attorney General Denison appearing on behalf of the United States, Mr. Charles W. Needham on behalf of the Interstate Commerce Commission and Mr. Samuel Untermeyer on behalf of the petitioner. Thereupon the cause was taken under advisement by the Court.

1158

*Opinion.*

Filed April 21, 1913.

United States Commerce Court, March Session, 1913.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,  
 vs.  
 THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COM-  
 MERCE COMMISSION, Intervener.

On Final Hearing Upon Pleadings and Proof.

Mr. Samuel Untermeyer and Mr. Arthur M. Wickwire, with whom Mr. Samuel W. Moore was on the brief, for petitioner.

Mr. Winfred T. Denison, Assistant Attorney General, with whom Mr. Thurlow M. Gordon, Special Assistant to the Attorney General, as on the brief, for United States.

Mr. Charles W. Needham for Interstate Commerce Commission.

Before Knapp, Presiding Judge, and Hunt, Carland, and Mack,  
Judges.

1159

APRIL 21, 1913.

Carland, *Judge*:

By orders of the Interstate Commerce Commission made June 3, 1907, June 1, 1908, June 21, 1909, and May 31, 1910, there was established and promulgated a uniform system of accounts for steam railroads, and a classification of expenditures for additions and betterments. These orders and classifications provide that in classifying expenditures for improvements properly chargeable to additions and betterments, where parts of a railroad or a shop are abandoned and replaced by a new railroad or shop upon a new right of way or site, but serving the same territory, traffic, or purpose, the cost or estimated replacement value of the abandoned property, less salvage, shall be deducted from the cost of the new work and the balance only charged to the property account; and that the cost or value, less salvage, of the abandoned property shall be charged to operating expenses, provided that if the amount of the charge to operating expenses warrants a distribution of the loss over a series of years in the future the total amount may be charged into an account designated "Property abandoned account" during a term of years previously approved by the Commission.

Petitioner prays that the orders and classifications above mentioned be annulled in so far as the particular provision above specified is concerned, for the reason that the classification of expenditures for additions and betterments is unreasonable and beyond  
1160 the power of the Commission, and because the enforcement thereof will deprive petitioner of its property without due process of law. Petitioner bases its right to complain of said orders and classification upon the following facts:

Petitioner is the owner of a railroad which it maintains and operates, extending from Kansas City, Mo., to Port Arthur, Tex. The road was originally constructed with a ruling maximum grade of 1 per cent, though in the mountain district it ran as high as 1.35 per cent. It was a properly located well-constructed road and ample for the needs of the country through which it ran. In the course of time, with the great development of the country and the resultant increase in traffic which approached the limit of the road's capacity, the conditions warranted and rendered highly desirable such additions or improvements as would enlarge the road's capacity and permit traffic to be moved more rapidly and economically.

Two methods of increasing the capacity of the road were possible—one by double-tracking the road, the other by lowering the grades and permitting traffic to be moved more cheaply. The road is in active competition with powerful rivals in the same general territory, among which are the Southern Pacific, the Missouri, Kansas and Texas, the Missouri Pacific, the St. Louis Southwestern, the Texas and Pacific, the St. Louis and San Francisco, the Atchison,

1161 Topeka and Santa Fe, and the Rock Island. The character of the road as a trunk line having a long average haul and the prevalence of low-grade traffic—timber, coal, oil, and like commodities—entailed a low average freight rate. Under these conditions the management decided that the most desirable plan was to lower the grades of the road and thus increase its capacity, promote economy, and render better service to the public. Two methods of reducing the grades at various points along the line were presented, one by raising or lowering the roadbed on the existing right of way, the other by the construction of short sections of new road in substitution for portions of the old road in instances where the desired result could be thus obtained at less cost.

Petitioner determined to revise its grade to a maximum of 0.5 of 1 per cent at six different points or portions of its line by the construction of short sections of new road and the abandonment of road thus replaced. It was found that the cost of securing the desired gradient upon the original roadbed would be \$1,230,318.99, but that the same result could be obtained by means of relocations for a net expenditure of \$629,399.74. The actual expenditure on the six new locations, as ascertained on completion of the work and after the filing of the petition in this case, was \$763,798. But this in no wise affects the proportion of expenditure between relocations and grade reduction upon the original roadbed. In order to meet the necessary expenditure caused by the reduction of grade, and 1162 other improvements, in the manner determined upon, petitioner duly issued and sold \$10,000,000 of bonds, dated July 1, 1909, secured by its refunding and improvement mortgage of the same date.

Using the figures appearing in the petition for illustration, we have, as the cost of the grade reduction by relocations, \$629,399.74. The estimated cost of replacing the discontinued portions of the road is \$482,953. The salvage amounted to \$96,469, the difference being \$386,484. The orders and classification of the Commission complained of require that this sum of \$386,484 must be deducted from the total cost, leaving a net amount of only \$242,945.74 chargeable to additions and betterments, the said sum of \$386,484 to be charged to the current expenses of operation.

As a second ground upon which petitioner claims to have a right to attack the orders in question the following facts appear: Petitioner owns a shop and terminal plant at Shreveport, Louisiana. The shop with its equipment is not worn out or obsolete and is capable with ordinary running repairs of performing for an indefinite term the functions for which it was originally constructed. Petitioner has determined as an integral part of an extensive program of interrelated improvements to construct, and is now engaged in constructing, a new and enlarged shop and terminal plant at Shreveport on a new and different location from that of the shop and terminal plant now existing, which last-mentioned shop and 1163 terminal plant are incidentally to be abandoned. The value of the Shreveport shop and terminal plant so to be abandoned is approximately \$100,000. The orders and classification

complained of require that the estimated replacement value, less salvage, of said shop and terminal plant now existing shall be charged to petitioner's operating expense account in monthly installments distributed over a period of time to be designated by the Commission, whereas petitioner insists that it has the right to charge the value of the shop and terminal plant when abandoned, less salvage, against its accumulated surplus as represented in its profit and loss account.

It is evident that the object which the Commission had in view in making the classification of expenditures for additions and betterments was to cause the property account of any railroad to show only the property it had in use and to eliminate therefrom all property which had been abandoned. It is also evident that the underlying basis for the contention of petitioner is that it desires to retain in its property account the replacement value, less salvage, of the pieces of road abandoned. It sufficiently appears in the record that what are known as the strong roads financially do not object to the classification of the Commission, for they are quite willing to charge the replacement cost of property abandoned against current operating expenses, as they have the right to earn operating expenses without question. On the other hand, roads that are less strong financially, among which petitioner classes itself, desire to

1164 keep the property account as large as possible because it is a material asset upon which to maintain credit.

In order to clear the case of matters which might lead to confusion, it is proper to say that as to mere bookkeeping this court has no power or authority to interfere with the orders of the Interstate Commerce Commission; and bookkeeping includes all matters relating to the manner or form in which an entry shall be made. In order that this court may interfere, a classification prescribed by the Commission must be such as unlawfully interferes with petitioner's property rights. As to the power of Congress to vest in the Commission, in the manner set forth in section 20 of the Act to Regulate Commerce, authority to establish a uniform system of accounts, and to require annual reports with a uniform balance sheet, and to determine the classification and form of such accounts we have no doubt. The decisions of the Supreme Court have settled this proposition beyond controversy. (*St. Louis and Iron Mt. Ry. v. Taylor*, 210 U. S., 287; *Union Bridge Company v. United States*, 204 U. S., 364; *The Dan'l Ball*, 77 U. S., 557; *Employers' Liability Cases*, 207 U. S., 497; *United States v. Goodrich Transit Co.*, 224 U. S., 191.)

The real questions for decision are clearly stated in the brief of counsel for the Commission, as follows: 1. Did the Commission act in an unreasonable and arbitrary way in requiring the carriers, when making improvements and betterments chargeable to property account, to deduct from the cost of these improvements and

1165 charge to operating expense account the value or estimated value, less salvage, of the property abandoned? 2. Is the requirement that the value or estimated value, less salvage, of abandoned property be charged to the operating expense account a

violation of any right guaranteed to the petitioner by the Constitution of the United States?

The orders in controversy were made in pursuance of the command of the statute. The complaint of the petitioner that the orders are an arbitrary exercise of power by the Commission does not relate to the manner of its procedure, but relates to the inherent effect which the orders and classification may have upon petitioner's property rights. The Commission in making the orders complained of was establishing a uniform system of accounts and classification for all railroads subject to the provisions of the act. It was impossible to establish separate systems for each railroad if the system for all of them was to be uniform; hence it is not surprising that the system of accounts established does not operate upon all roads alike. The object which the Commission had in mind, however, was the same in all cases. The charge that the making of the orders was an arbitrary exercise of power is based upon the claim that upon no theory of correct accounting can the Commission require petitioner to deduct from the cost of additions and betterments the value or estimated value, less salvage, of property abandoned and to charge the value or estimated value, less salvage, of the property abandoned to operating expenses.

1166 We are not at liberty to invalidate the orders of the Commission on this ground, for there is abundant evidence in the record that the method required by the orders of the Commission is a correct and proper one. The testimony is conflicting, but Messrs. Farrington, Bailey, and Adams, gentlemen of high repute in the profession of accounting, testified unqualifiedly that the method adopted by the Commission was a correct and proper one. In addition to this expert testimony is the authority of Mr. Robert H. Montgomery, author of the work *Auditing—Theory and Practice*, page 319; also Whitten on *Valuation of Public Service Corporations*, chap. 19, sec. 450 et seq.

Do the orders complained of deprive petitioner of its property without due process of law? To compel petitioner for the purpose of regulation by the Interstate Commerce Commission to charge out of its property account property abandoned in improvements for additions and betterments, certainly does not deprive it of any property. Property abandoned ought not to appear in any account unless in an abandoned property account. Petitioner insists, however, that in the case under consideration there is no abandonment of property. It appears to us like abandonment, and we think it so appeared when counsel for petitioner framed the paragraph of the petition which reads:

"The said six sections of your petitioner's line were well located at the time the road was constructed, and were, at the time of the abandonment thereof, reasonably well adapted to the needs of your petitioner."

1167 We further think that the effect of charging the replacement value or cost of abandoned property, less salvage, in connection with additions and betterments in the operating expense account, is overestimated. We, of course, can not pass upon

the wisdom of the requirement complained of. Whether or not the matter might have been handled through the profit and loss account with better results is not for us to decide. If the requirement does not affect the property rights of petitioner, this court can afford no relief. The charge in the operating expense account is accompanied by the explanatory statement, "Property abandoned because of conditions and betterments." It does not pretend to be an expenditure of money and, therefore, might properly be found in some other account; but its entry in the operating expense account deprives petitioner of no property, and if the effect of the entry will be to reduce the net revenue from which dividends are to be paid, still the preferred stockholders can not complain as, the reduction being lawful, they receive as much as they are lawfully entitled to receive.

The improvements which caused the abandonment were made with money derived from the sale of bonds, and as the improvements were in fact thus made the mortgage bondholders have no reason to complain and no person, with the proper explanatory note in connection with the entries required to be made, would be in any way deceived.

In view of the foregoing we are clearly of the opinion that with such statements upon the records of the corporation in connection with the entry required by the orders of the Commission as petitioner has the right to make it will not be deprived of any property or illegally injured in any way.

In regard to the provision contained in the "Classification of expenditures for additions and betterments," which allows a distribution of the loss over a series of years in the future, the total amount to be charged into an account designated "Property abandoned account," with the approval of the Commission, we must assume that the Commission would grant such privilege in any case where it was reasonable to do so. We can not in advance of any application by petitioner for this privilege assume that it would be denied.

Following the course of the discussion at bar, principal attention has been given to the matter of grade reduction, but what we have said is intended to apply as well to the matter of the shop and terminal plant at Shreveport.

At the time the testimony in this case was taken before a judge of this court, certain letters written to the Commission approving the manner in which the Commission by its orders has required the cost of abandoned property, less salvage, to be entered, as heretofore stated, were offered in evidence by counsel for the United States, and the same were excluded as hearsay. The same matter has been again presented to this court, and after due consideration we are of

the opinion that the letters were properly excluded. Counsel for the United States claim that the letters were admissible for the purpose of showing that the Commission did not act arbitrarily. As we have before stated in this opinion, there is no claim in this case that the procedure in connection with the making of the orders complained of was irregular or arbitrary, but that the inherent effect of the orders themselves demonstrated that the orders were an arbitrary exercise of power. The orders were made pursuant



to the command of the statute. The Commission could have made them without consulting any one, and the fact that the Commission received such letters as were offered in evidence was immaterial, and the letters themselves, if material, were mere hearsay.

It is claimed that the orders and classifications complained of are arbitrary for the reason that if the grade reductions had been made on the original right of way no deduction from capital account of property abandoned would have been required, and that there is no reason for making any distinction between the two methods of grade reduction. We do not think petitioner is in a position to urge this contention, as it voluntarily adopted the method of relocation for grade improvements and it is with reference to that method that the orders and classifications must be tested. In other words, if they are valid as to grade reductions made by relocations, they may not be avoided because of their effect on other methods of grade reduction not followed by petitioner.

The petition will be dismissed, and it is so ordered.

1170 In the United States Commerce Court, March Session, 1913.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervener.

*Final Decree.*

(Entered April 29, 1913.)

This cause came on for final hearing at this session and was argued by counsel; and thereupon, upon consideration thereof, it was ordered, adjudged and decreed that the petition be, and the same is hereby, dismissed at the cost of the petitioner.

By the Court:

MARTIN A. KNAPP,

*Presiding Judge.*

1171

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Petition for Allowance of Appeal.*

(Entered May 12, 1913.)

Comes now the petitioner in the above entitled cause and, feeling aggrieved by the order and final decree of the Court entered herein on the 29th day of April, 1913, prays for an order allowing an appeal from the said order and decree to the Supreme Court of the United States; and for an order fixing the amount of security which the petitioner shall be required to furnish as a cost bond upon the said appeal.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,

By SAMUEL UTERMAYER,  
SAMUEL W. MOORE,  
ARTHUR M. WICKWIRE,*Its Solicitors.*

Dated May 10, 1913.

1172

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Assignment of Errors.*

(Filed May 12, 1913.)

Comes now the Petitioner in the above entitled cause and makes the following assignment of errors to the order and decree of the Court in the above entitled cause;

**I.**

The Court erred in holding that the regulation of the Interstate Commerce Commission, embodied in its order dated June 21, 1908 and effective July 1, 1909, and the Classification of Expenditures for

Additions and Betterments for Steam Roads therein referred to, whereby common carriers are required, where portions of the line are discontinued or "abandoned" as an incident to the revision of the grades of the road, to charge the estimated cost of replacing in kind the discontinued or "abandoned" portions of line to Operating Expenses,—was a valid exercise of power on the part of the Commission.

## II.

The Court erred in holding that the Interstate Commerce Commission had power to compel the Petitioner to charge to Operating Expenses the estimated cost or value of portions of its line discontinued or "abandoned" as an incident to the revision of its grades; whereas the undisputed evidence showed that such item or items were not an Operating Expense.

## III.

The Court erred in holding that the regulation of the Interstate Commerce Commission, embodied in its said orders and Classification, whereby common carriers are required, where portions of its property are discontinued or "abandoned" as an incident to improvement, to charge the estimated cost of replacing in kind the discontinued or "abandoned" property to Operating Expenses—was a valid exercise of power on the part of the Commission.

## IV.

The Court erred in holding that the enforcement of said regulations would not result in taking the Petitioner's property without due process of law.

## V.

The Court erred in holding that the enforcement of said regulations would not result in taking the property of the Petitioner's preferred stockholders without due process of law.

## VI.

The Court erred in holding that said regulations were not an arbitrary or unreasonable exercise of power.

## VII.

The Court erred in failing to hold that the promulgation of said regulations was an exertion of authority manifested in such an unreasonable manner as to be outside the power and authority of the Interstate Commerce Commission.

## VIII.

The Court erred in failing to hold that said regulations of the Commission, if enforced, would result in undue and unlawful inter-

ference with the Petitioner, its stockholders and directors in respect to the conducting of the internal management of the Petitioner's affairs.

IX.

The Court erred in failing to hold that said regulations of the Commission, if enforced, would result in undue and unlawful interference with an usurpation of the functions of the directors of the Petitioner in the internal management of its affairs.

X.

The Court erred in holding that the Petitioner did not have the right to charge the estimated cost or value of property discontinued or "abandoned" in connection with improving its facilities against its accumulated surplus as represented in its profit and loss account.

XI.

The Court erred in holding that "as to mere bookkeeping the Court has no power or authority to interfere with the orders of the Interstate Commerce Commission."

1175

XII.

The Court erred in holding that there was sufficient evidence in the record to show that the method of accounting required by the orders of the Commission was a proper and correct one.

XIII.

The Court erred in holding that it was not within its power to determine whether the Petitioner had the right to charge off the cost or value of discontinued or "abandoned" property to profit and loss account.

XIV.

The Court erred in holding that no person, with the proper explanatory notes in connection with the entries required to be made by the regulations above referred to would be in any way deceived thereby.

XV.

The Court erred in ordering that the petition be dismissed.

SAMUEL UNTERMYER,

SAMUEL W. MOORE,

ARTHUR M. WICKWIRE,

*Solicitors for Petitioner.*

Dated, May 10, 1913.

1176

## United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Supplemental Assignment of Errors.*

(Filed May 14, 1913, Nunc pro Tunc as of May 12, 1913.)

Comes now the Petitioner in the above entitled cause and amends the assignment of errors by making the following supplemental assignment of errors to the order and decree of the Court in the above entitled cause:

**XVI.**

The Court erred in failing to hold that the Petitioner's property as a whole was increased in value by the improvements in reduction of grades involving changes of line to the extent at least of the expenditures made for such improvements.

**XVII.**

The Court erred in failing to hold that the Petitioner's property as a whole was increased in value by the improvements to its shops and terminal plant at Shreveport, Louisiana, to the extent at least of the expenditures made for such improvements.

**XVIII.**

The Court erred in failing to hold that the expenditures made by the Petitioner in improving the grades of its line should be entered in the Petitioner's Capital Account in order properly to represent the transaction.

SAMUEL UTERMAYER,  
SAMUEL W. MOORE,  
ARTHUR M. WICKWIRE,

*Solicitors for Petitioner.*

Dated, May 13, 1913.

Let this supplemental assignment of errors be entered nunc pro tunc as of May 12, 1913.

MARTIN A. KNAPP,  
*Presiding Judge.*

1178

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner  
v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Order Allowing Appeal.*

(Entered May 12, 1913.)

The prayer of the petitioner for allowance of appeal in the above entitled cause coming on to be heard, an appeal is hereby allowed to the Supreme Court of the United States to review the order and final decree dismissing the petitioner's complaint hereinbefore entered in this cause, and the cost bond is hereby fixed at \$250.00.

Dated, this 12th day of May, 1913.

MARTIN A. KNAPP,  
*Presiding Judge.*

1179

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner.  
VERSUS

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Cost Bond on Appeal.*

(Filed May 12, 1913.)

Know all men by these presents, that National Surety Company, Corporation under the Laws of the State of New York, with its principal place of business, at  $\pm$  115 Broadway, in the City of New York County and State of New York, is held and firmly bound unto the United States of America, and the Interstate Commerce Commission, in the above entitled cause in the sum of two hundred fifty dollars, (\$250) to be paid by the petitioner subject to the following conditions:

Whereas, the petitioner in the above entitled cause has sued on an appeal to the Supreme Court of the United States to reverse the order and final decree entered in the United States Commerce Court in said cause on the twenty-ninth day of April, in the year of our Lord Nineteen Hundred Thirteen.

Now, therefore, the condition of this obligation is such that if the

said petitioner shall prosecute such petition to effect and answer all costs if it fails to make the said appeal good, then this obligation to be void, but otherwise to remain in full force and effect.

Dated, this Seventh day of May, A. D. 1913.

[SEAL.]

NATIONAL SURETY COMPANY,

By W. C. ARMITAGE, *Vice-President*.

Attest

J. R. WELLS,

*Assistant Secretary.*

1180 STATE OF NEW YORK,

*County of New York, ss:*

On this 7th day of May, 1913, before me personally appeared W. C. Armitage, Vice-President of the National Surety Company, with whom I am personally acquainted, who, being by me duly sworn, said that he resides in the County of New York; that he is the Vice-President of the National Surety Company, the corporation described in and which executed the within instrument; that he knows the corporate seal of said Company; that the seal affixed to the within instrument is such corporate seal; that it was affixed by order of the Board of Directors of said Company, and that he signed said instrument as Vice-President of said Company by like authority, and that the liabilities of said Company do not exceed its assets, as ascertained in the manner provided in Section 183 of Chapter 33 of the Laws of New York for the year 1909, constituting Chapter 28 of the Consolidated Laws of the State of New York. And the said W. C. Armitage further said that he is acquainted with J. R. Wells and knows him to be the Assistant Secretary of said Company; that the signature of the said J. R. Wells subscribed to the said instrument is in the genuine handwriting of the said J. R. Wells and was thereto subscribed by the like order of the said Board of Directors and in the presence of him, the said Vice-President.

[NOTARIAL SEAL.]

H. E. EMMETT,

*Notary Public for Kings County, No. 4.*

Certificate filed in New York County, No. 2. Queens, Richmond and Westchester Counties. Kings County Register's Office No. 3953. New York County Register's Office No. 4009.

### *Copy of By-Law.*

Be it remembered: That at a regular meeting of the Board of Directors of the National Surety Company, duly called and held on the sixth day of February, 1912, a quorum being present, the following By-Law was adopted:

### Article XIII.

SECTION 1. Signatures required.—All bonds, recognizances, or contracts of indemnity, policies of insurance, and all other writings

obligatory in the nature thereof, shall be signed by the President, Vice-President, a Resident Vice-President, or Attorney-in-Fact, and shall have the seal of the Company affixed thereto, duly attested by the Secretary, an Assistant Secretary, or Resident Assistant Secretary. All Vice-Presidents and Resident Vice-Presidents shall each have authority to sign such instruments, whether the President be absent or incapacitated, or not, and the Assistant Secretaries and Resident Assistant Secretaries shall each have authority to seal and attest such instruments, whether the Secretary be absent or incapacitated, or not; and the Attorneys-in-Fact shall each have authority, in the discretion of such Attorneys-in-Fact, to affix to such instruments an impression of the Company's seal, whether the Secretary be absent or incapacitated, or not, or to attach the individual seal of the Attorney-in-fact thereto, or to use the scroll of the Attorney-in-Fact, or a wafer, wax, or other similar adhesive substance affixed thereto, or a seal of paper or other similar substance affixed thereto by mucilage, or other adhesive substance, or use the word "seal" or the letters "L. S." opposite the signature of such Attorneys-in-Fact, as the case may be.

STATE OF NEW YORK.

*County of New York, ss:*

I, J. R. Wells, Assistant Secretary of the National Surety Company, have compared the foregoing By-Law with the original thereof, as recorded in the Minute Book of said Company, and do certify that the same is a correct and true transcript therefrom, and the whole of said original By-Law.

Given under my hand and the seal of the Company, in the County of New York, this 7th day of May, 1913.

[N. S. CO.'S CORPORATE SEAL.]

J. R. WELLS,  
*Assistant Secretary.*

Approved May 12, 1913.

MARTIN A. KNAPP,  
*Presiding Judge.*

1181

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,  
v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Præcipe for Transcript*

(Filed May 14, 1913.)

To the Clerk of the United States Commerce Court:

You will please prepare a transcript of the record in the above entitled case to be filed in the office of the Clerk of the Supreme Court



of the United States under the appeal heretofore perfected to said Court, and include in said transcript the following pleadings, orders, testimony, exhibits and papers:

1. Petition for Injunction, with exhibits attached.
2. Answer of the United States.
3. Motions to extend time to answer.
4. Orders extending time to answer.
5. Motion of Interstate Commerce Commission for leave to amend answer.

6. Order allowing motion to amend answer.

7. Answer of Interstate Commerce Commission, and exhibits attached.

8. Order amending Petition.

- 1182 9. Order designating Judge Hunt to hear testimony.

10. Order designating Judge Carland to hear testimony.

11. Testimony and exhibits before Judges Hunt and Carland as printed for the use of the Commerce Court.

12. Stipulations as to evidence.

13. Copies of Exhibits excluded from printing in accordance with said stipulation.

14. Copy of journal entry showing record of final hearing.

15. Opinion directing dismissal of petition.

16. Order and decree dismissing petition at cost of Petitioners.

17. All appeal papers.

Said transcript of the record to be prepared as required by law and the rules of this Court and the rules of the Supreme Court of the United States, and to be filed in the office of the Clerk of the Supreme Court of the United States on or before June —, 1913.

SAMUEL UNTERMYER,

SAMUEL W. MOORE,

ARTHUR M. WICKWIRE,

*Solicitors for Appellant.*

1183 United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, a Corporation,  
Petitioner,

vs.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervener.

UNITED STATES OF AMERICA, *ss.*

I, G. F. Snyder, Clerk of the United States Commerce Court, do hereby certify that the above and foregoing transcript, together with the originals of such exhibits to the testimony taken before Judge Hunt, March 5, 1912, and before Judge Carland May 6, December 10, 11, 12, 13, 14, and 16, 1912, at Washington, as were not printed in full for the use of the Commerce Court, (on pages num-

bered 1 to 1182 inclusive), constitutes a complete record of the proceedings in the above entitled cause, made in accordance with the precept filed in the Clerk's Office of said United States Commerce Court.

In testimony whereof I have hereunto set my hand and affix the seal of the United States Commerce Court this 21st day of May, A. D. 1913.

[Seal of the United States Commerce Court.]

G. F. SNYDER, *Clerk*.

1184 United States Commerce Court. Filed May 12, 1913, G. F. Snyder, Clerk.

United States Commerce Court.

No. 56.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, Petitioner,  
v.

THE UNITED STATES OF AMERICA, Respondent; INTERSTATE COMMERCE COMMISSION, Intervenor.

*Citation.*

The United States of America to the United States and the Interstate Commerce Commission, Greeting:

You are hereby cited and admonished to be and appear in the Supreme Court of the United States, at the City of Washington, D. C. thirty days from and after the day this citation bears date, pursuant to an appeal filed in the Clerk's Office of the United States Commerce Court in the above entitled suit, to show cause, if any there be, why the order and decree rendered against the said appellant, as in said appeal mentioned, should not be corrected, and why speedy justice should not be done the parties in that behalf.

Witness the Honorable Martin A. Knapp, Judge of the United States Commerce Court, this 12th day of May in the year of our Lord 1913.

MARTIN A. KNAPP,  
*Presiding Judge.*

1185 Service of the foregoing citation is hereby waived.

WINFRED T. DENISON,  
*For the United States.*

CHAS. W. NEEDHAM,  
*For the Interstate Commerce Commission.*

1186 [Endorsed:] United States Commerce Court. The Kansas City Southern Railway Company, Petitioner v. The United States of America, Respondent, Interstate Commerce Commission, Intervenor. Original. Citation. Guggenheimer, Untermeyer & Marshall, Solicitors for Petitioner, No. 37 Wall Street, Borough of Manhattan, City of New York.

1187 In the Supreme Court of the United States, October Term, 1913.

No. 571.

KANSAS CITY SOUTHERN RAILWAY COMPANY, Appellant,  
v.  
UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION, Appellees.

*Stipulation.*

It is hereby stipulated and agreed by and between the parties to the above entitled cause by their respective solicitors that the following documents attached to the answer of the Interstate Commerce Commission as exhibits, viz:

"Exhibit A, Classification of Expenditures for Additions and Betterments as prescribed by the Interstate Commerce Commission for Steam Roads, in accordance with Section 20 of the Act to Regulate Commerce, First Issue, effective on July 1, 1909;

"Exhibit B, Classification of Expenditures for Additions and Betterments as prescribed by the Interstate Commerce Commission for Steam Roads, in accordance with Section 20 of the Act to Regulate Commerce, First Revised Issue, effective on July 1, 1910;

"Exhibit C, Form of General Balance Sheet Statement as prescribed by the Interstate Commerce Commission for Steam Roads, in accordance with Section 20 of the Act to Regulate Commerce, First Revised Issue, effective on June 15, 1910;

"Exhibit D, Classification of Operating Expenses as prescribed by the Interstate Commerce Commission, in accordance with Section 20 of the Act to Regulate Commerce, Third Revised Issue;

"Exhibit E, Supplement to the Third Revised Issue of the Classification of Operating Expenses as prescribed by the Interstate Commerce Commission for Steam Roads, in accordance with Section 20 of the Act to Regulate Commerce, effective on July 1, 1908,"

need not be printed in the record in the above entitled cause, but that sufficient printed copies thereof shall be furnished by the parties and filed with the Clerk of the Court for use on the hearing of the

1188 appeal, and the copies so furnished may be used by the court and the counsel to all intents and purposes as though printed in the record.

SAMUEL UNTERMYER,  
SAMUEL W. MOORE,

*Solicitors for Appellant.*

BLACKBURN ESTERLINE,

*Special Assistant to the Attorney General,  
for the United States.*

CHAS. W. NEEDHAM,

*Solicitor for Interstate Commerce Commission.*

July 11, 1913.

[Endorsed:] 571—13—23717.

1189 [Endorsed:] File No. 23,717. Supreme Court U. S., October term, 1912. Term No. 571. Kansas City Southern Railway Company, Appellant, vs. United States of America et al. Stipulation to omit parts of record in printing. Filed July 15, 1913.

Endorsed on cover: File No. 23,717. U. S. Commerce Court. Term No. 571. The Kansas City Southern Railway Company, appellant, vs. The United States and The Interstate Commerce Commission. Filed May 24th, 1913. File No. 23,717.

# Vol. II.

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## TRANSCRIPT OF RECORD.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1913.

No. 571.

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THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
APPELLANT,

vs.

THE UNITED STATES AND THE INTERSTATE COMMERCE  
COMMISSION.

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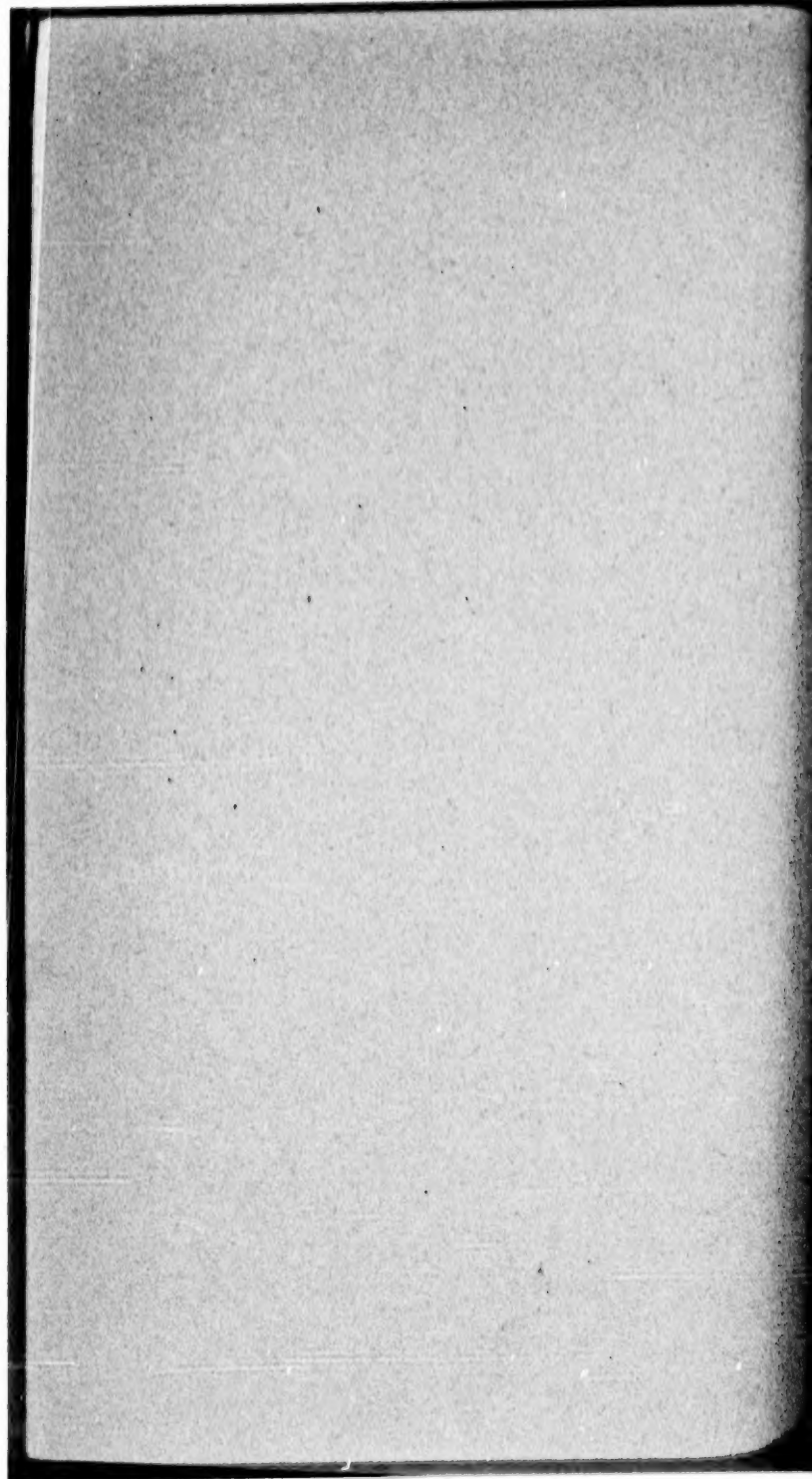
APPEAL FROM THE UNITED STATES COMMERCE COURT.

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FILED MAY 24, 1913.

(23,717)



NO. 56

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In The United States Commerce Court.

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THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
petitioner,

v.

THE UNITED STATES OF AMERICA, RESPONDENT,  
INTERSTATE COMMERCE COMMISSION, INTERVENER.

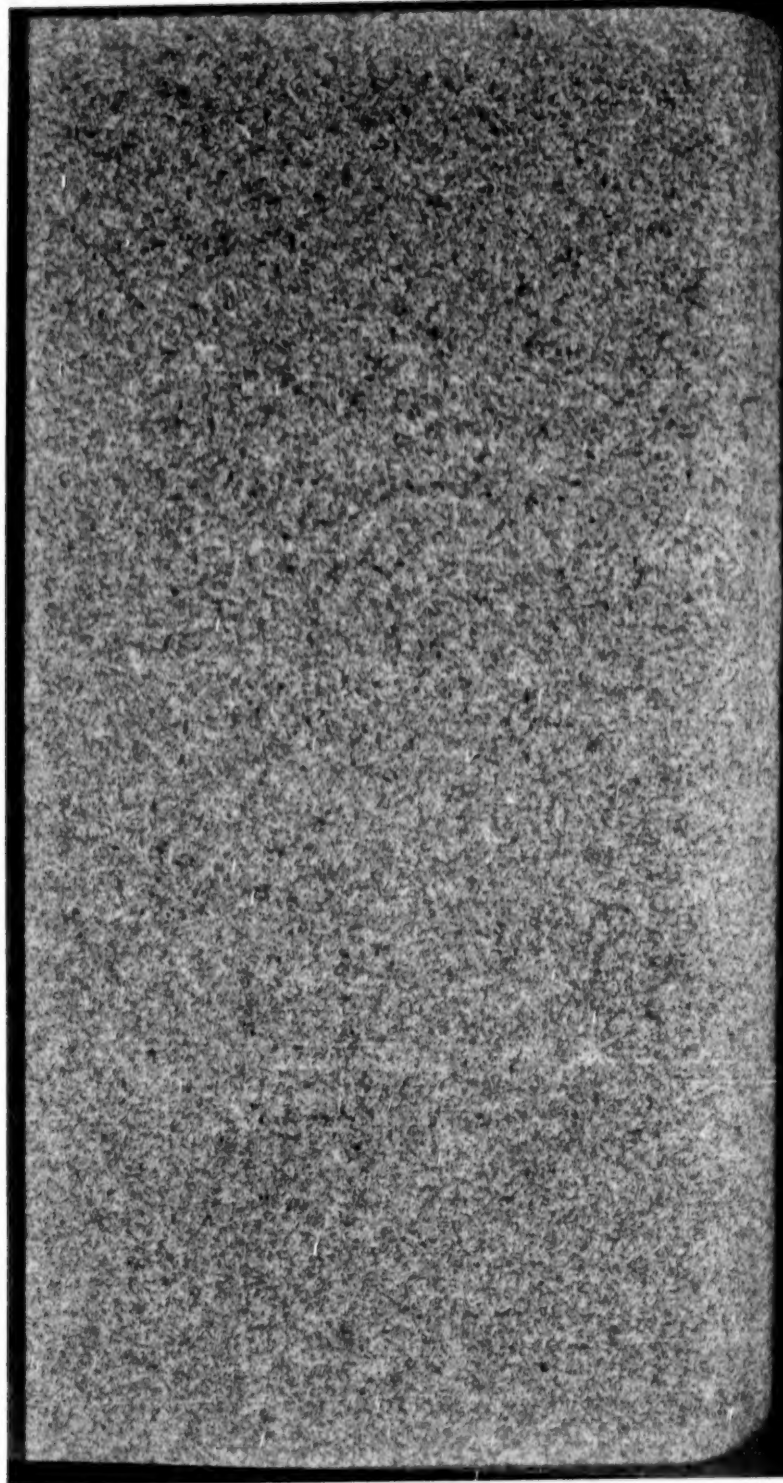
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REPORTER'S TRANSCRIPT OF TESTIMONY, WITH EXHIBITS  
THEREON, TAKEN BEFORE JUDGE HUNT, MARCH 5, 1913,  
AND JUDGE CARLAND, MAY 6, DECEMBER 11, 12, 13, 14,  
AND 16, 1913, AT WASHINGTON, D. C.

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Filed January 29, 1913.

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# In The United States Commerce Court.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, PETITIONER,  
 v.  
 THE UNITED STATES OF AMERICA, RESPONDENT, INTERSTATE  
 Commerce Commission, intervening respondent.

No. 56.

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# In The United States Commerce Court.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY, PETITIONER,

THE UNITED STATES OF AMERICA, RESPONDENT, INTERSTATE  
Commerce Commission, intervening respondent.

No. 56.

WASHINGTON, D. C.,

*Tuesday, March 5, 1912.—10.30 o'clock a. m.*

Present: Mr. Justice Hunt.

Appearances: Mr. Samuel Untermeyer for the petitioner. Mr. Winfred T. Denison, Assistant Attorney General, for the United States of America, respondent. Mr. Thurlow M. Gordon, special assistant to the Attorney General, also for the United States of America, respondent. Mr. Charles W. Needham for the Interstate Commerce Commission, intervening respondent.

## PROCEEDINGS.

MR. UNTERMEYER. Your honor is very familiar with the case, and we will not make any opening statement. We will proceed directly to the presentation of the evidence. We will just call our first witness.

I will have Mr. Loree sworn.

L. F. LOREE, a witness called on behalf of the petitioner, being first duly sworn, testified as follows:

Direct examination by Mr. UNTERMEYER:

Q. State your full name.—A. L. F. Loree.

Q. Where do you reside?—A. New York.

Q. What is your occupation?—A. I am chairman of the board and chairman of the executive committee of the Kansas City Southern Railway.

Q. Are you connected with other railroads?—A. Yes, sir; I am president of the Delaware and Hudson Company.

Q. Are you associated with other railroads?—A. Yes, sir.

Q. As director and member of executive committees?—A. Yes, sir.

Q. How long have you been connected with railroads?—A. Since 1877.

Q. Have you had a practical education as a railroad man?—A. Yes, sir.

Q. Will you be good enough to state, Mr. Loree, your experience with railroads and in the railroad business, and how it began, so we may understand fully as to your qualifications to discuss the subject here in issue?—A. I began service with the Pennsylvania in 1877, and I was in the engineer corps after that for a couple of years, and in 1881 and 1882 I was with the Mexican National Railroad.

Q. In what capacity?—A. As locating engineer. From 1882 until 1901 I was with the Pennsylvania Railroad in various capacities from division engineer to vice president; and from 1901 until 1904 I was with the Baltimore & Ohio Railroad as president, and I was president of the Rock Island Company in 1904, and since 1906 I have been with the Kansas City Southern Railroad, and since 1907 with the Delaware & Hudson Company.

Q. Will you be good enough to describe generally the Kansas City Southern Railway?—A. The Kansas City Southern Railway is a railway that runs from Kansas City, Missouri, almost due south to Port Arthur, on the Gulf of Mexico.

By the Court:

Q. Where is Port Arthur?—A. Port Arthur is about eighty miles east of Galveston.

By Mr. UNTERMYER:

Q. What is the mileage of the Kansas City Southern?—A. The main line is 786 miles long.

Q. And what is the total mileage operated, including branches?—A. It has, in addition to that, the Arkansas Western Road, about thirty miles in length.

Q. In 1906 you became connected with the Kansas City Southern Railway Company?—A. Yes, sir; I think in the spring of 1906.

Q. What was the character of its business and what is the character of its business now?

Mr. DENISON. May it please the court, I think perhaps at this time I had better state an objection on behalf of the Government to this specific question, and, if your honor will permit, to all other questions based upon any other issue than what the Government conceives to be the sole issue of fact to be tried by this court, namely, whether, on the matter before the commission, its ruling was arbitrary or unreasonable.

The position of the Government is that this court has no jurisdiction to go de novo into testimony on the substance of the question, but that its sole function is to determine whether or not the Interstate Commerce Commission acted on what it had before it, either arbitrarily or without any basis of reason; and consequently we object to any questions upon other lines, and we object to any questions going to the general propriety of this order further than to show to your honor and to the Commerce Court what was or what was not before the Interstate Commerce Commission and what proceedings that commission took before it issued this order.

The Court. You do not contend, do you, that this court is without power to hear testimony in support of an application to issue an injunction against an order made by an administrative body?

Mr. DENISON. Yes, your honor; we contend that this court is without power to hear any testimony further than testimony as to what was before the Interstate Commerce Commission and what its proceedings were on the subject. In other words, the position of the United States is that the determination of the Interstate Commerce Commission on any question of fact of policy or administrative policy or legislative policy is absolutely final.

Mr. UNTERMYER. I take it the purpose of this objection is to reserve the question for final argument?

MR. DENISON. The purpose is to make the objection.

MR. USTERMYER. It is your purpose that the testimony shall be excluded at this time?

THE COURT. I want to understand clearly the position of counsel.

MR. USTERMYER. We claim that under the guise of a mere administrative order, and under the guise of legislative power, simply to determine the form of account, it does not lie within the power of the Interstate Commerce Commission to run our road and to destroy the value of our securities; and for the purpose of showing our situation and the effect of this order, and that the Interstate Commerce Commission has exceeded its power, it becomes necessary for us to go into the history of this road and its present status and the class of its business and the effect and purpose of these improvements.

THE COURT. I will, for the purpose of giving you the full benefit of your objection, overrule the objection, and admit all testimony to which you desire to preserve your exception as admitted over the objection of the Government.

MR. DENISON. And your honor will allow us the exception?

THE COURT. The benefit of an exception to each and every question propounded.

MR. DENISON. I shall not have to repeat the objection?

THE COURT. Oh, no. Sometimes the form of the question may be so objectionable that a special objection would be well taken, but to the substance we will deem the objection applicable always, and an exception noted.

MR. USTERMYER. May I inquire if the case is at issue as to the Government?

MR. DENISON. The case is at issue as to the Government, and I may say incidentally we are on final hearing, and the answer of the Government takes the position which I have stated.

MR. USTERMYER. I do not understand the Government has filed any answer.

MR. DENISON. Oh, yes; we have; here is a copy of it [indicating].

THE COURT. You may proceed, Mr. Ustermyer.

MR. USTERMYER. Will you read the question, Mr. Stenographer?

THE STENOGRAPHER (reading):

What was the character of its business and what is the character of its business now?

THE WITNESS. The main business of the road is the transportation of lumber, which originates along the southern end of the line and has a market in the North. That constituted, at that time, about forty-eight per cent of its business. It has considerable business in the transportation of oil and in the transportation of coal, and it does a merchandise business—transports merchandise and passengers. Its business is a long-haul, low-grade business.

By MR. USTERMYER:

Q. What proportion of its business originates on its own line?—

A. I should say, roughly, about fifty-five per cent.

Q. What is the extent of its competition?—A. It is exposed to active competition along the whole line of the road.

Q. Has it more than one competitor?—A. It has a number of competitors—the Southern Pacific, the St. Louis & San Francisco,

the Atchison, Topeka & Santa Fe, and the Rock Island. It has a number of competitors.

Q. How do its rates compare with the rates of competitors?—A. They are substantially alike.

Q. When you entered into the management of the road, did you undertake any examination through experts of its condition?—A. I went over the line of the road with the officers of the company and looked pretty carefully into its business and into its facilities for doing business and into its equipment and the character of the line; and subsequently, upon the authorization of the board, I employed Mr. H. G. Burt to make an examination of the property, with a view of bringing it into condition for economical operation.

Q. When was that?—A. In 1906 and 1907.

Q. Who was Mr. Burt?—A. Mr. Burt had been chief engineer of the Chicago & Northwestern line and vice president of that company, and subsequently president of the Union Pacific line, and had had a great deal of experience in revising grades and preparing properties for economical operation.

Q. Do you remember how long his investigation lasted?—A. It lasted about a year.

Q. Did it result in a very complete and voluminous report, with recommendations?—A. It did. He had as many as seven parties in the field and made a thorough investigation of the physical possibilities, and made a very full report on the question.

Q. The entire purpose of the investigation was to advise with respect to reductions in grades for the purpose of securing more economical operation, was it not?—A. Yes, sir.

Q. When was that report rendered?—A. My recollection is, in 1907.

Q. Was any action taken upon it by the board?—A. Yes, sir. The board authorized the sale of bonds to provide money for the improvements contemplated, and bonds were sold and the money provided for that purpose.

Q. That report cost the company about \$150,000, did it?—A. It did.

Q. The cost of that investigation was about \$150,000?

Mr. NEEDHAM. I do not think that is a material question. I do not see how the cost of that bears upon the question at issue. However, the point I rose to make is that if the court regards the resolution or the action of the board as material, of course we should have the resolution of the board.

Mr. UNTERMYER. We are going to produce that.

The COURT. That, of course, would be the best evidence. I should think it was a mere circumstance, among others, tending to show the care with which the examination was made, and that any action had was based upon the best technical advice that could be had.

Mr. UNTERMYER. And the further fact that all this expense was incurred and all this work was done before this order was promulgated, and we propose to follow it up by showing the commitments we made.

The COURT. You mean before the order of the Interstate Commerce Commission?

Mr. UNTERMYER. Yes, your honor; before the order of the Interstate Commerce Commission.

The COURT. There is no question about that—that this was all done before the order of the Interstate Commerce Commission.

MR. UNTERMYER. The purpose of all this is to show we made contract commitments as to this money with which to make these improvements, that we have vested rights, and that the purpose of this order has changed or has attempted to change our status; and we take the position there is no legal right in the commission to make an order that would invalidate our existing contracts and affect the security of the mortgage we have given for the money we have borrowed.

MR. NEEDHAM. The fact, as I understand it, is that the action by the stockholders had reference entirely to a different improvement than was made. That is why I asked for the resolution.

MR. UNTERMYER. I think you will find you are wrong about that.

By MR. UNTERMYER:

Q. The cost of that investigation to the company was how much?—A. About \$150,000.

Q. I forgot to ask, in connection with the character of the freight being handled by the Kansas City Southern, whether or not it is of a character that requires prompt and rapid transportation?—A. It does.

Q. Does it consist to some extent of packing-house products?—A. We have some packing-house business, and the competition is so keen that all the business has to be moved with promptness.

MR. UNTERMYER. If your honor please, we now offer in evidence first the resolution of the board of directors of the company at a meeting held April 28, 1909, duly certified under seal of the corporation. We have the original here.

MR. NEEDHAM. It is understood this all goes in under the objection made and exception noted?

The COURT. Certainly.

MR. DENISON. Was that April 28, 1909?

MR. UNTERMYER. Yes.

MR. DENISON. A resolution of the board of directors?

MR. UNTERMYER. Yes.

The resolution referred to was thereupon read to the court, being marked Petitioner's Exhibit No. 1, and is in the words and figures following to wit:

I, G. C. HAND, secretary of the Kansas City Southern Railway Company, do hereby certify that the annexed is a true and correct copy of a preamble and resolutions adopted by the board of directors of the said company at a meeting duly called and held April 28, 1909, and of each and every part thereof.

[SEAL.]

G. C. HAND,

*Secretary, The Kansas City Southern Railway Co.*

NEW YORK, March 2, 1912.

UNITED STATES OF AMERICA.

*City, county, and State of New York ss:*

At New York, this second day of March, 1912, before me, a notary public in and for the county of New York, personally appeared G. C. HAND, secretary of the Kansas City Southern Railway Company, to me personally known and known to me to be secretary of the Kansas City Southern Railway Company and the person mentioned and described in and who acknowledged the foregoing certificate, and he duly acknowledged to me that he executed the same as secretary of the Kansas City Southern Railway Company.

In witness whereof, I have hereunto affixed my name and notarial seal this day and year first above written.

[SEAL.]

JESSE MYERS,  
Notary Public, New York County, No. 44.

My commission expires March 30th, 1913.

Whereas the present seems a favorable opportunity to fund permanent the outstanding collateral gold notes aggregating \$5,100,000;

Whereas in view of the constantly growing business of this company it is impossible to provide for the enlargement of the capacity of its railroad and the development of its facilities out of the surplus earnings alone;

Whereas it is probable that the constant increase of the company's business will require additions to and improvements of its property, and it is believed to be prudent and desirable that provision shall now be made so far as possible for the future needs of the company;

Whereas this plan involves the retirement of the \$5,100,000 of collateral gold notes;

Whereas Messrs. Ladenburg, Thalmann & Co. have entered into a contract with the company subject to the approval of this board and of the stockholders which is herewith submitted; and

Whereas the executive officers of the company have recommended the approval of such contract; now therefore be it resolved:

1. That this company make an issue limited to \$21,000,000 par value of its gold bonds which shall bear interest at the rate of 5% per annum as to \$10,000,000 thereof, and as to the balance shall bear interest at such rate not exceeding 5% as the directors may from time to time determine, which bond shall become due April 1st, 1960, and shall be secured by a mortgage covering all the present and after-acquired property and franchises of the company in the general form of the accompanying proposed mortgage and shall be second lien thereon, subject only to the outstanding issue of \$30,000,000 of first mortgage gold bonds;

2. That \$10,000,000 par value of such bonds be sold in conformity with the terms of the aforesaid contract with Messrs. Ladenburg, Thalmann & Co. at the net price to the company of 96 1/2% of the par value with accrued interest yielding the company a total net sum of \$9,625,000 and accrued interest;

3. That the outstanding \$5,100,000 collateral trust gold notes be now called for redemption on July 1st, 1909, by appropriate notices to be given under the terms of the collateral trust indenture securing the same, which notice shall be served not later than May 1st, 1909;

4. That said bonds be sold to Messrs. Ladenburg, Thalmann & Co. and their associates, who may include firms of bankers, members of which are directors of the company and including also other directors, but subject also to the prior right of the stockholders to acquire from the purchasers by subscription such bonds at par, and accrued interest in the proportion of their holdings of stock;

5. *Resolved*, That if, for any reason, the issue and sale of the aforesaid \$10,000,000 of bonds, part of the issue of \$21,000,000 of bonds above referred to shall not be authorized by the stockholders, there shall be sold to Messrs. Ladenburg, Thalmann & Co. and their associates, under terms of the aforesaid contract, at the price of 92% of the par value thereof and accrued interest, \$10,000,000 par value of the existing 4 1/2% improvement mortgage bonds, provided the stockholders shall ratify the last mentioned sale, and that meantime the officers of the company are authorized, if they see fit, to borrow from Messrs. Ladenburg, Thalmann & Co. the moneys necessary to pay and retire the collateral trust notes on July 1st, 1909;

6. *Resolved*, That inasmuch as certain of the directors, whose interests are now disclosed to the board, but who are not present, and have taken no part in the proceedings, are, or expect or desire, to be interested in said contract with Messrs. Ladenburg, Thalmann & Co., all matters covered by these resolutions with respect to the new issue of bonds, and of the alternative sales of the bonds above mentioned, shall be subject to the authorization and ratification of, and are hereby referred to a special meeting of stockholders to be called to be held at 9:00 o'clock a. m. on the twenty-ninth day of June, 1909, at the office of the company at Kansas City, Mo., for the purposes specified in the accompanying notice, which is herewith submitted and read, and directed to be spread in full upon the minutes of this meeting.



## NOTICE OF SPECIAL MEETING OF STOCKHOLDERS.

*To the Stockholders of the Kansas City Southern Railway Company:*

You are hereby notified that a special meeting of the stockholders of the Kansas City Southern Railway Company is hereby called to be held on June 20th, 1909, at 9.00 o'clock a. m., standard time, at the general offices of the company, in the Thayer Building, at the northwest corner of Ninth Street and Broadway, at Kansas City, Missouri, to consider and vote upon each and all of the following propositions:

1. To authorize an issue limited to \$21,000,000 par value, of gold bonds of the company to become due April 1, 1950, bearing interest at the rate of five per cent per annum as to \$10,000,000 of said bonds, and as to the remainder at a rate or rates to be fixed by the directors, not exceeding five per cent, to be secured by a mortgage covering all the present and after-acquired property and franchises of the company. The bonds and the mortgage to secure the same to be in such form, and contain such covenants and conditions as may be approved by the executive officers of the company.

2. To authorize and consent to a sale by the company to Messrs. Ladenburg, Thalmann & Co. of \$10,000,000 par value, part of the aforesaid issue of \$21,000,000 of bonds, which it proposed to ask the stockholders to authorize at this meeting, at a net price to the company of 96 $\frac{1}{2}$ % of the par value of such bonds, yielding the company the net amount of \$9,625,000, and to ratify the contract heretofore made by the company, subject to the approval of the stockholders for the sale of said bonds to Messrs. Ladenburg, Thalmann & Co., but subject to the prior right of the stockholders to acquire from the purchasers by subscription such bonds in the proportion of their holdings of stock at the closing of the books of the company for the transfer of stock for the purposes of the meeting at the par value of such bonds.

Said contract so made by Messrs. Ladenburg, Thalmann & Co. for themselves and on behalf of their associates, including members of the board of directors, will be submitted for the approval of the meeting. It is provided by said contract that if for any reason the stockholders shall fail to authorize the issue of said \$21,000,000 issue of bonds, secured as aforesaid, Messrs. Ladenburg, Thalmann & Co. will purchase, and the company will sell to them for themselves and their associates, \$10,000,000, par value, of the existing 4 $\frac{1}{2}$ % improvement mortgage bonds at the price 92 per cent of the par value thereof and accrued interest.

The stockholders will be asked to vote on the last proposal if they shall fail to authorize the issue of the \$21,000,000 mortgage bonds and the sale of \$10,000,000 par value thereof, as provided in the proposed contract with Messrs. Ladenburg, Thalmann & Co.

3. To authorize and consent to the underwriting of said \$10,000,000 of bonds by Messrs. Ladenburg, Thalmann & Company, Blair & Company, Kean, Van Cortlandt & Co. and their associates, each of which firms of bankers is represented in the board of directors, and notwithstanding their official relations to the company.

4. To authorize and consent that individual directors and officers may become purchasers of such bonds and members of the underwriting syndicate and participate in the profits and commissions thereof for their individual benefit notwithstanding their positions as directors or officers.

5. To ratify the action of the officers and directors of the company in having called for redemption and payment on July 1st, 1909, with interest to date of redemption, the entire outstanding issue of \$5,100,000 par value of five per cent collateral gold notes secured by a pledge of \$6,000,000 par value of mortgage bonds of the company, being part of a total authorized issue of \$10,000,000 of such bonds as the four and one-half per cent twenty-year improvement gold bonds.

6. Upon the retirement, redemption, and cancellation of the aforesaid issue of notes and the return to the company of the \$6,000,000 improvement mortgage bonds held as collateral therefor, to cancel, satisfy, and discharge the said improvement mortgage and the bonds secured thereby, so that the \$21,000,000 authorized issue of bonds to be secured as above set forth shall constitute a lien and charge upon the present and after-acquired property and franchises of the company next and subsequent only to the outstanding issue of \$30,000,000 of 3% first mortgage gold bonds.

7. To authorize the transaction of such other business connected with or pertaining to the above-mentioned subjects as the stockholders may deem proper.

The books for the transfer of stock, both common and preferred, will be closed for the purposes of the meeting at the close of business on the tenth day of June, 1909, and will be open at 10 o'clock a. m. on the first day of July, 1909.

By order of the board of directors.

J. A. EDSON, *President*,  
R. B. SPERRY, *Secretary*.

Dated April 29th, 1909.

By MR. UTERMAYER:

Q. Following the passage of this resolution which I have just read, as passed by the directors, was there a circular issued to the stockholders?—A. There was; yes, sir.

Q. And is this [indicating] a copy of the circular?—A. It is; yes, sir.

MR. UTERMAYER. That I will offer in evidence as Exhibit No. 2, your honor.

MR. NEEDHAM. Subject to the same objection.

MR. UTERMAYER. Yes.

The circular referred to, marked "Petitioners' Exhibit No. 2," is in the words and figures following, to wit:

THE KANSAS CITY SOUTHERN RAILWAY.

I, G. C. HAND, secretary of the Kansas City Southern Railway Company, do hereby certify that the annexed is a true and correct copy of a communication addressed by Hermann Stelcken, then chairman of the board of directors, to the stockholders of the said company under date of May 20, 1909. The said copy is taken from the files of the said company, and a counterpart thereof appears to have been forwarded, on or about the date set forth, to its stockholders and each and every one of them.

[SEAL.]

G. C. HAND,  
*Secretary the Kansas City Southern Railway Co.*

NEW YORK, March 2, 1912.

UNITED STATES OF AMERICA,  
City, County, and State of New York } ss:

At New York, this second day of March, 1912, before me, a notary public in and for the county of New York, personally appeared G. C. HAND, secretary of the Kansas City Southern Railway Company, to me personally known and known to me to be the secretary of the Kansas City Southern Railway Company and the person mentioned and described in and who acknowledged the foregoing certificate, and he duly acknowledged to me that he executed the same as secretary of the Kansas City Southern Railway Company.

In witness whereof I have hereunto affixed my name and notarial seal the day and year first above written.

[SEAL.]

JESSE MYERS,  
*Notary Public, New York County, No. 114.*

My commission expires March 30th, 1913.

25 BROAD STREET, OFFICES OF THE  
KANSAS CITY SOUTHERN RAILWAY COMPANY.  
New York City, May 20, 1909.

To the stockholders of the Kansas City Southern Railway Company:

Your directors desiring to take advantage of the present favorable opportunity to refund permanently the outstanding collateral gold notes, aggregating \$5,100,000, and realizing the impossibility because of the constantly and rapidly growing business of the company to adequately provide for the enlargement of the capacity of your railway and the development of your facilities out of surplus earnings alone, believe it to be prudent and desirable that provisions shall now be made so far as possible for the future financial needs of the company.

It is proposed, with your authority, to cancel the present improvement mortgage bonds, aggregating \$10,000,000; to call and pay off the outstanding collateral gold notes, aggregating \$5,100,000; and to create \$21,000,000 refunding and improvement bonds, bearing interest at not exceeding five per cent per annum, due April 1, 1950, but redeemable at the option of the railway at 105 and accrued interest on any interest date upon sixty days' previous notice, and be secured by all of the property and franchises of your company owned and hereafter acquired, subject to the existing lien thereon. Of this amount is proposed to presently issue and sell \$10,000,000 five per cent gold bonds, be dated July 1, 1909, with interest payable January 1st and July 1st, except to the last coupon, to be generally applied as follows:

To pay off the collateral gold notes on July 1, 1909	\$5,100,000
To reducing grades to one-half of one per cent on three full operating divisions, aggregating 41 per cent of the total length of the line	1,250,000
To rearranging four division terminals to permit of better and more economical operation under the sixteen-hour law and to provide more adequate facilities for taking care of the power and traffic	1,000,000
To ditching, ballasting, new rail, improvements to track and bridges	1,000,000
The balance to be used for the improvement of terminal facilities at Kansas City and Port Arthur for facilities for securing new business and for other corporate purposes	1,275,000
Total	9,625,000

The \$10,000,000 bonds proposed to presently be issued have been sold to Messrs. Ladenburg, Thalmann & Co., subject to your approval at a special meeting called for that purpose for June 20, 1909, a copy of which notice and all is enclosed herein and which fully sets forth the terms of such sale.

One of the conditions of said contract is that the bonds shall be offered at par and accrued interest to both common and preferred stockholders of record at the close of business on June 10, 1909, to the extent of 19.60 per cent of their holdings. This privilege must be availed of by the stockholder on or before June 24, 1909, at 3 o'clock p. m.

The date of payment of such subscription is June 20, 1909.

As the bonds are issued in denomination of \$1,000 each, stockholders who are entitled to subscribe to a fraction may, until and including the close of business June 24, 1909, consolidate fractions into even amounts of \$1,000. The company will not buy or sell fractions.

Subscriptions must be made on the form of warrant which will be mailed to each stockholder of record on June 10, 1909, or as soon as practicable after that date.

The rights of subscription will terminate at 3 o'clock p. m. on June 24, 1909, and subscriptions must be lodged on or before that date with Messrs. Ladenburg, Thalmann & Co., 25 Broad Street, New York, or with the Amsterdamsch Trustee's Kantoor, Nieuwendijk 197-199, Amsterdam, Holland, who will issue their own receipts for payment made thereunder in accordance with the terms of the warrant of subscription.

For the purpose of the special meeting above referred to and of ascertaining the names of stockholders who shall be entitled to subscribe to said bonds the books of transfer of stock, both common and preferred, will be closed at the close of business on June 10, 1909, and will be reopened at 10 o'clock a. m. on July 1, 1909.

A proxy is enclosed which stockholders who do not intend to be present at the meeting in person are requested to sign and return as soon as possible to the office of the company, 25 Broad Street, New York City, in the addressed envelope enclosed.

By order of the board of directors.

HERMANN SIECKEN, *Chairman.*

By MR. UTERMAYER:

Q. At the time of the issuance of this circular, the contract had been executed with Messrs. Ladenburg, Thalmann & Company of ten million dollars of bonds for the purposes designated in Exhibit No. 2, had it not?—A. It had.

Q. And the form of mortgage had been agreed upon, had it not?

A. It had.

Mr. UTERMAYER. I offer in evidence the mortgage which was made by the Kansas City Southern pursuant to this resolution, but I do not want to incorporate in the record the entire mortgage. I only want to put in two clauses, one on pages 30-31 and one on page 45, as follows:

The construction of tunnels and bridges and the reduction of grades or change of line upon any of the lines of railroad then subject to this indenture.

This is a statement of the purposes for which the money was to be used:

The purchase of rolling stock and other equipment for use upon any of the lines of railroad then subject to this indenture.

The purchase and improvement of additional real estate for use in connection with the operation or maintenance of any of the lines of railroad then subject to this indenture; the construction, purchase, or acquisition of terminals, stations, yards, sidings, industrial tracks, shops, depots, warehouses, and other structures which shall be required or be useful or convenient in the operation or maintenance of any of the lines of railroad then subject to this indenture; and the construction or purchase of other additions to and improvements and betterments of and upon any of the lines of railroad then subject to this indenture.

(Page 45.) In the statement of what shall constitute default is the following:

In case (4) default shall be made in the due observance or performance of any other covenant or condition herein required to be kept or performed by the railway company, and such default shall have continued for a period of six months after written notice thereof shall have been given to the railway company by the trustees.

The document referred to and quoted from was thereupon marked "Petitioner's Exhibit No. 3" and is filed herewith.

Mr. UTERMAYER. Your honor will observe all this we are offering as having taken place before the promulgation of this order.

Mr. NEEDHAM. If your honor please, I do not wish to request that the whole mortgage be put in the record, but such parts of it as he desires. However, I would like to have the mortgage filed so we can refer to it if we want to, with the understanding we can refer to any part we want to after we have looked it over.

The COURT. Mr. Utermayer, what is the date of the mortgage?

Mr. UTERMAYER. The date of the mortgage is the first of July 1909, but the mortgage was agreed upon when the contract for the sale of the bonds was made.

The COURT. I understand. It may appear in the record that at this point you offered that mortgage, dated July 1, 1909, and such part of it as may be desired will be copied in the record.

Mr. UTERMAYER. It is understood the document in its entirety will be now filed for court and counsel, but that in printing the record it will not be necessary to print the entire mortgage, but only such parts as either party may desire to have printed.

I do not care at this time to read anything further than the following from page 30 of the mortgage just referred to:

The construction of tunnels and bridges and the reduction of grades or change of line upon any of the lines of railroad then subject to this indenture.

The purchase of rolling stock and other equipment for use upon any of the lines of railroad then subject to this indenture.

The purchase and improvement of additional real estate for use in connection with the operation or maintenance of any of the lines of railroad then subject to this indenture; the construction, purchase, or acquisition of terminals, stations, yards, sidings, industrial tracks, shops, depots, warehouses, and other structures which shall be required or be useful or convenient in the operation or maintenance of any of the lines of railroad then subject to this indenture; and the construction or purchase of other additions to and improvements and betterments of and upon any of the lines of railroad then subject to this indenture.

I call attention to the fact that the use of the money, by the terms of the mortgage, is limited to the specific purposes, and it can be used for these purposes only and for none other.

On page 45 of the mortgage, among the cases of default under article third, headed "Remedies upon default," and subdivision two of that article, it is provided that the causes of default shall include—

(4) If default shall be made in the due observance or performance of any other covenant or condition herein required to be kept or performed by the railway company, and such default shall have continued for a period of six months after written notice thereof shall have been given to the railway company by the trustees.

I call your honor's attention to the fact that the use of any of this money for purposes other than these specified in the mortgage is an occasion of default; that is, it must be an improvement, a capital improvement.

The mortgage will be considered filed as already suggested?

The COURT. Yes.

By Mr. UTERMAYER:

Q. Was there a meeting of the stockholders called after this contract had been entered into with Ladenburg-Thalman & Company for the sale of the bonds secured by the mortgage, Petitioner's Exhibit No. 3? A. There was.

Q. Is this [indicating] a certified copy of the resolution that was passed at that stockholders' meeting?—A. Yes, sir; it is.

Q. The meeting was held on what date?—A. June 29th, 1909.

Mr. UTERMAYER. I offer that in evidence as Petitioners' Exhibit No. 4.

The resolution referred to, marked Petitioners' Exhibit No. 4, is in the words and figures following, to wit:

THE KANSAS CITY SOUTHERN RAILWAY COMPANY.

I, G. C. Hand, secretary of the Kansas City Southern Railway Company, do hereby certify that the annexed is a true and correct copy of a preamble and resolution adopted by the common and preferred stockholders of the said company at a meeting duly called and held June 29, 1909, and of each and every part thereof.

[REAL.]

(Signed)

G. C. HAND,

Secretary The Kansas City Southern Railway Co.

New York, March 2, 1912.

UNITED STATES OF AMERICA, )  
City, County, and State of New York. ) ss:

At New York, this second day of March, 1912, before me, a notary public in and for the county of New York, personally appeared G. C. Hand, secretary of The Kansas City Southern Railway Company, to me personally known and known to me to be the secretary of the Kansas City Southern Railway Company and the person mentioned and described in and who acknowledged

the foregoing certificate, and he duly acknowledged to me that he executed the same as secretary of the Kansas City Southern Railway Company.

In witness whereof, I have hereunto affixed my name and notarial seal this day and year first above written.

[L. S.]

(Signed)

JESSE MYERS,

Notary Public, New York County, No. 14

My commission expires March 30th, 1913.

*Resolved*, That the stockholders of the company, both preferred and common, for the requirements of the business of the company, and to provide for corporate purposes, do consent to an increase in the bonded indebtedness of the company, and do sanction and approve of the creation, making, execution and delivery by the company of an issue of bonds, coupon and registered, to be known as refunding and improvement mortgage gold bonds, limited to the aggregate principal sum of twenty-one million dollars (\$21,000,000) par value at any time issued and outstanding, said bonds to become due and payable April 1st, 1950, and to bear interest at the rate of 5 per cent per annum as ten million dollars (\$10,000,000) thereof, which are to be presently issuable and as to the remainder thereof which are to be issuable subsequent to July 1st, 1910, at a rate or rates not to exceed 5 per cent, to be fixed by the board of directors or the executive committee of the company; all such bonds to be redeemable at a premium of 5 per cent at the option of the company, on any day on which interest is payable; and that the stockholders in all respects authorize the making, execution, and issue of such series of bonds, and all the acts of the board of directors and of the executive committee of the company relating in anywise to the creation and issue thereof; and be it further

*Resolved*, That, in order to secure the payment of the principal and interest of said series of refunding and improvement mortgage gold bonds of the company, the stockholders of the company, both preferred and common, do sanction, consent to, and approve of the making and execution by this company of mortgage or deed of trust to the New York Trust Company and Edward F. Swinney, as trustee, as a first lien and charge upon all the present and after acquired property and franchises of the company, subject only to certain equipment trusts executed by the company to Messrs. Blair & Company, bankers and to the Equitable Trust Company of New York, and to a certain mortgage executed by the company to the Mercantile Trust Company and Selwyn Edgar, as trustees, to secure an issue of thirty million dollars (\$30,000,000) par value of 3 per cent gold bonds of the company, such mortgage to be substantially in the form and to contain substantially the same covenants and conditions as those contained in the form of mortgage submitted to the meeting, such other covenants and conditions, and such modifications thereof, as the executive committee of the company may approve, and the bonds to be secured thereby, both coupon and registered, and the coupons to be attached to the coupon bonds to be in a form substantially as set forth in said mortgage deed of trust, submitted to the meeting, and containing such other covenants and conditions as the executive committee may approve, and hereby authorize and be it further

*Resolved*, That the stockholders, both common and preferred, approve in all respects the making, execution, and delivery of such mortgage, and ratify, approve, and confirm, consent to, and assent to, all the acts and resolutions of the board of directors and of the executive committee in reference to the making and execution thereof; and be it further

*Resolved*, That when the board of directors or the executive committee of the company so direct, the president or any vice president of the company, such other officer as the board of directors or the executive committee may designate, be, and he hereby is, authorized and directed, for and on behalf of the company and in its name (the preferred and common stockholders of the company hereby expressly assenting to such act) to sign said mortgage or deed of trust, and to execute the same and acknowledge the execution thereof, and affix or cause to be affixed thereto its corporate seal, and that the secretary, such other officers as the executive committee or the board of directors may designate for such purpose, be authorized and directed to attest the same and acknowledge the execution thereof, and to deliver the same so executed, attested and acknowledged to the New York Trust Company and Edward F. Swinney as trustees, and that the stockholders of this company approve, ratify, and confirm all the resolutions passed and to be passed by the board of directors

or the executive committee and all the acts of the officers of the company done or which may be done within the contemplation of this resolution, and that all such acts so authorized, ratified, and approved are declared to be valid corporate acts performed by due corporate authority; and be it further

*Resolved*, That when and as directed by the board of directors or the executive committee of the company the president or any vice president, or such other officer as the board of directors or the executive committee of the company may designate for such purpose, shall sign the bonds to be issued pursuant to this resolution in the name and on behalf of the company, and shall affix or cause to be affixed thereto its corporate seal, and that said bonds shall be attested by the secretary or such other officer as the board of directors or the executive committee of the company may designate for such purpose, and shall be delivered to the New York Trust Company, as trustee, for authentication in accordance with the provisions of said indenture of mortgage or deed of trust, and shall thereafter be sold and delivered at such times, in such manner, and at such price as may be resolved by the board of directors or executive committee of the company and as may be consistent with the terms of the mortgage securing the same; and be it further

*Resolved*, That the respective acts of the officers of the company and the acts and resolutions of its board of directors and executive committee, done and performed pursuant to or within the contemplation of this resolution, shall be deemed and taken to be valid corporate acts performed by due corporate authority; and be it further

*Resolved*, That pursuant to the provisions of said mortgage or deed of trust the said officers may forthwith execute, issue, and deliver one or more temporary bond or bonds in the form and of the character substantially as provided in said mortgage or deed of trust of the aggregate face value of ten million dollars (\$10,000,000), and may deliver the same to the New York Trust Company for authentication, which temporary bond shall be exchangeable for engraved bonds when ready for issuance, as in said mortgage provided; and be it further

*Resolved*, That the sale by the company to Messrs. Ladenburg, Thalmann & Company of \$10,000,000 par value of said bonds out of the aforesaid issue of \$21,000,000 par value thereof at a net price to the company of 94½ per cent of the par value thereof, yielding to the company a net amount of \$9,625,000, subject, however, to the prior right of the stockholders of the company to acquire from the said purchasers by subscription, as set forth in the circular letter to stockholders of May 20, 1909, any part of the said \$10,000,000 par value of bonds in the proportion of their holdings of stock of the company at the time of the closing of the books of the company for the transfer of stock for the purposes of this meeting at the par value of such bonds and accrued interest, and all and singular the terms and conditions of said sale of said \$10,000,000 of refunding and improvement mortgage gold bonds as shown by the contract between the company and the said Messrs. Ladenburg, Thalmann & Company, which contract, bearing date the 26th day of April, 1909, was submitted to this meeting and has been ordered spread in full on the minutes thereof, and all acts of the officers and board of directors and executive committee of the company done pursuant to or in connection with or in contemplation of said sale be, and the same hereby are, in all respects accepted, adopted, confirmed, ratified, and approved; and be it further

*Resolved*, That the officers of the company be, and they hereby are, fully authorized and empowered to perform and carry out the said sale of the said \$10,000,000 par value of said refunding and improvement gold bonds at the said price and upon the terms and conditions in said agreement set forth, and do and perform all such things as may be required by the company thereunder, for and on behalf of the company and all the preferred and common stockholders thereof; and be it further

*Resolved*, That any underwriting of said ten million dollars (\$10,000,000) of bonds or any part thereof by Messrs. Ladenburg, Thalmann & Company, Blair & Company, Kean, Van Cortlandt & Company, and their associates, each of which firm of bankers is represented in the board of directors of the company, notwithstanding their official relations to the company, be, and is hereby, ratified and approved, and they are hereby authorized and permitted to enjoy for their own account and benefit any and all profits therefrom accruing or in any wise resulting; and be it further

*Resolved*, That the directors and officers of the company be, and they hereby are, authorized and permitted to become purchasers for their own account and



benefit of any and all such bonds and to become members of the underwriting syndicate and to participate in the profits and commissions thereof for their own use and benefit, and notwithstanding their positions as such directors or officers of the company, and that any purchase made, underwriting taken or received, or profits or commissions participated in in connection with the said bonds or any part thereof, or the issue thereof, or of any part thereof, by any director or officer is hereby expressly consented to and is hereby expressly approved; and be it further

*Resolved*, That the action of the officers and directors of the company in having called for redemption and payment on July 1, 1909, with interest to the date of redemption, the entire outstanding issue of \$5,100,000 par value of 5 per cent collateral gold notes of the company, secured by a pledge of \$6,000,000 par value of mortgage bonds of the company, being part of a total authorized issue of \$10,000,000 of said bonds, known as the 4½ per cent twenty-year improvement gold bonds of the company, be, and the same hereby is, in all respects ratified, confirmed, and approved; and be it further

*Resolved*, That the officers and directors of the company be, and they hereby are, authorized and directed upon the retirement or redemption or cancellation, or upon providing for such retirement, redemption, or cancellation of the aforesaid issue of notes of the company, and upon the return to the company of the \$6,000,000 par value of improvement mortgage bonds held as collateral therefor, to proceed forthwith to cancel, satisfy, and discharge the said improvement mortgage and the bonds secured thereby, so that the \$21,000,000 authorized issue of bonds to be secured as herein provided shall constitute a lien and charge upon the present and after-acquired property and franchises of the company next and subsequent only to certain equipment agreements mentioned therein and to the outstanding issue of \$30,000,000 three per cent first mortgage gold bonds of the company; and be it further

*Resolved*, That out of the moneys realized from the sale of said \$10,000,000 par value of new bonds, as above provided, the officers of the company be, and they hereby are, authorized and empowered to set apart out of the moneys so realized a sum equal to and sufficient to fully cancel and discharge the present outstanding issue of \$5,100,000 par value of gold notes of the company called for redemption as aforesaid on the first day of July, 1909; and be it further

*Resolved*, That the board of directors and executive committee of the company be, and they hereby are, authorized and empowered to use so much of the proceeds of said \$10,000,000 par value of bonds as may not be required for the purpose of redeeming the \$5,100,000 par value of gold notes of the company, as provided above, for all and every of the purposes provided therefor in the mortgage securing the same and for every other and further lawful corporate use of the company, and not inconsistent therewith; and be it further

*Resolved*, That the officers and directors of the company be, and they hereby are, authorized and directed to do all and every further and additional act or thing and to sign, execute, and deliver all papers, writing, deeds, assignments, instruments, records, certificates, and the like, that may be necessary, proper, or convenient to carry out or effectuate any and all of the foregoing resolutions or purposes and every part thereof.

By Mr. UTERMAYER:

Q. Do you remember whether it was in April, and if so, on what day in April that the commitment was made with the bankers, and the contract executed for the sale of these bonds?

Mr. DENISON. According to the resolution, it is dated April 26, 1909.

The WITNESS. That is my recollection.

By Mr. UTERMAYER:

Q. That is your recollection?—A. Yes, sir.

Q. At that time was there any intimation, so far as you knew, of any intention on the part of the Interstate Commerce Commission to promulgate the orders of which complaint is now made?—A. No, sir.



Q. Have you had prepared, Mr. Lorce, a statement showing the average length of ton haul in miles of the Kansas City Southern, and the average freight rate per ton per mile in cents of that company as compared with its competitors?—A. Yes, sir.

Q. Is this [indicating] a correct copy of that statement?—A. Yes, sir. Those figures are taken from the annual reports of those companies.

Mr. UNTERMYER. I offer that in evidence, your Honor, as petitioners' Exhibit No. 5.

The statement referred to was thereupon read to the court, being marked "Petitioners' Exhibit No. 5," and is in the words and figures following, to wit:

*The Kansas City Southern Railway Company: Average length of ton haul in miles—average rate per ton-mile in cents.*

	1906-07	1907-08	1908-09	1909-10	1910-11
AVERAGE HAUL (MILES)					
The Kansas City Southern Ry....	318.24	312.55	287.25	275.39	256.63
Southern Pacific Co.—Rail lines....	270.59	283.59	266.90	255.32	231.77
Missouri, Kansas & Texas System....	244.74	236.57	219.94	216.66	196.68
The Missouri Pacific System....	244.55	234.65	231.31	232.61	235.42
St. Louis Southwestern System....	239.38	240.82	243.22	260.12	245.55
The Texas & Pacific Ry....	203.04	211.66	185.06	185.28	184.27
St. Louis & San Francisco R. R....	164.55	161.49	155.54	158.69	156.21
AVERAGE RATE—CENTS					
The Kansas City Southern Ry....	.793	.723	.749	.725	.787
The Missouri Pacific System....	.793	.791	.815	.813	.857
St. Louis & San Francisco Ry....	1.010	.970	1.010	.980	1.050
The Texas & Pacific Ry....	1.039	.960	1.030	1.030	1.010
St. Louis Southwestern System....	1.050	1.010	1.080	1.040	1.080
Missouri, Kansas & Texas System....	1.076	1.040	1.042	1.050	1.130
Southern Pacific Co.—Rail lines....	1.105	1.097	1.154	1.162	1.175

The statement includes revenue freight only.

The Texas & Pacific Ry.—Calendar years ending at the middle of fiscal years.

New York, March 2, 1912.

By Mr. UNTERMYER:

Q. In order to compete it was essential you should make those grade reductions?—A. We thought so.

Q. And reduce cost of operation?—A. We thought so; yes.

Q. In authorizing this bond issue and the expending of these moneys in grade reductions, I think you said your board approved and acted upon this report of Mr. Burt?—A. They had that before them; yes, sir.

Mr. UNTERMYER. I would like to have this report filed as an exhibit, so that either party can extract from it anything they want to.

What I want to offer now from the report is as follows, on page 8, showing what the board acted on in many of these improvements:

Fourth. With grades reduced to the basis of 0.5 per cent, the present expense movement, 2.83 mills for revenue ton-mile of the Kansas City Southern Railway, can at least be cut in half and the road be placed in a position to handle the lowest classes of traffic offering, at a profit.

By Mr. UNTERMYER:

Q. What had been the average grade before this reduction?—A. The ruling grade was 1 per cent. There were grades of 1.35 per cent on different parts of the line.

Q. Some of those that were reduced were how steep? A. 1.35 per cent.

By the COURT:

Q. You reduced them to 0.5 per cent?—A. Yes, sir.

Q. That was your uniform reduction?—A. In the work we have done we have reduced to 0.5 per cent. Some of the line we did not propose to change, but have put in Mallet locomotives to handle the traffic.

By Mr. UNTERMYER:

Q. But there are grade reductions in prospect, are there not?—A. Yes, sir.

Q. And under consideration?—A. Yes, sir.

Mr. UNTERMYER. On pages 18 and 19 of Mr. Burt's report, there is a discussion of the proposed revision of grades and the alignment of the Kansas City Southern, which we particularly want considered in evidence, as follows:

Discussion of proposed revision of grades and alignment of the Kansas City Southern Railway.

The object of grade revision is to effect a reduction in the cost of railway operation by increasing the trainload and correspondingly decreasing the number of trains required to move a given traffic. The same results, within certain limits, may be obtained by an increase in the tractive power of the locomotives employed, and when both means are employed together the most effective results are obtained.

The adoption of any scheme of grade revision is dependent upon several factors the most important of which are: first, the physical characteristics of the territory to be traversed; second, the density of traffic to be moved; the former as affecting the practicability and cost of revision, the latter as furnishing the justification therefor. It would perhaps be more suitable to reverse the order of these factors, for with a density of traffic sufficiently large, physical obstacles may generally be largely overcome. Both of the above factors in the case of the Kansas City Southern Railway are known, the latter being derived from traffic statistics of the railway company, the former having been ascertained by examinations and instrumental surveys of the territory made during the past year.

The economic basis of grade revision is the increased trainload which results in a saving of train-miles; but grade revision frequently involves changes and duplication of line which materially affect the relative length of road to be operated, and to that extent the net saving of train-miles, and in such cases curvature and rise and fall, which count in the net results of revision, are also affected. In order, therefore, to determine the net results of grade revision, the several elements of cost which enter into and affect it must be determined, and to these elements must be assigned proper values "per train mile," or "per train," and "per mile of road," etc., per annum.

The operating expenses of a railway are usually divided into two classes, viz. Fixed and movement expenses, terms which are sufficiently self-explanatory. The movement expenses, with which grade revision is principally concerned, are subdivided into "freight" and "passenger" and these again are still further subdivided into the several classes corresponding with the different departments of railway operation and maintenance. The unit of measure for movement expenses is the "train-mile," and the several units of cost are determined thereby.

The "Burt" report referred to by counsel was thereupon filed and is marked "Petitioners' Exhibit No. 6."

NOTE. The following extracts from the report are printed in the record by direction of the petitioner's counsel. See letter of January 6, 1913, addressed to the Solicitor of the Interstate Commerce Commission and attached to the original record.—Clerk

## PETITIONER'S EXHIBIT No. 6.

Mr. L. F. LOREE,

*Chairman Executive Committee, the K. C. S. Ry. Co.,**No. 25 Broad Street, New York.*

DEAR SIR: I beg to submit herewith report on the matter of the revision of gradients and alignment of the Kansas City Southern Railway, the investigation of which subject was undertaken last August in accordance with an understanding had with you at New York in the month of July preceding. The objects of the investigation are:

First. The determination of such changes and revisions in the gradients and alignment of the main line of the Kansas City Southern Railway, Kansas City, Mo., to Port Arthur, Tex., as will provide for the future commercial and operating requirements of the railway in the most efficient and economical manner practicable, the estimated cost of such improvements, together with the amount of the justifiable expenditure therefor; and

Second. The determination by divisions or districts of those changes and revisions (included in paragraph first) that are now of the most importance and will give the largest immediate return in proportion to the outlay, together with the amount of such outlay and the justifiable expenditure required for such improvements.

The determining physical factors of economy in the operation of a railway, like the Kansas City Southern, are the ruling gradient and the relative length of line. The more important of these factors, in the case of the Kansas City Southern Railway, is the one of ruling gradient, and its importance varies directly with the volume of freight traffic. In the building of most western railways the question of economy of operation, even when appreciated at its full significance (which was rarely the case), had to be held secondary to the more pressing question of first cost of construction, which was a condition precedent to building at all; or, if taken into account, it was not infrequently subordinated to the more easily obtained, as well as less costly requirement, of a short line (with heavy ruling gradient) between the initial and objective points. The case of the Kansas City Southern Railway furnishes no exception to this rule. It will not be understood, however, from what has been said, that little weight is attached to the "shore line" feature of the Kansas City Southern Railway; on the contrary, in view of the possibilities of grade reduction, and in connection therewith, that feature assumes an increased importance.

In the consideration of the matter of grade revision in any case the first question is whether such revision is absolutely essential to the future growth and welfare of the railway; the second whether the expenditure required for such revision is justifiable by the existing volume of traffic. The determination of proper answers to these questions involves a careful consideration and review of the business, present and prospective, of the railway under consideration, and frequently, as in the case of the Kansas City Southern Railway, exhaustive examinations and surveys for the purpose of determining the proper location and cost of the proposed improvements.

The following table shows for the calendar year 1906 the grain and grain products through the ports of New Orleans, Galveston, and Port Arthur—all the grain shown at the last named port being handled by the Kansas City Southern Railway:

TABLE 2.

Port.	Barricks of flour.	Barricks of:			Total.
		Wheat.	Corn.	Oats.	
Port Arthur.		1,270,796	1,196,067		2,466,863
New Orleans.	1,219,867	5,675,853	17,337,459	5,417,779	29,050,949
Galveston.	401,121	11,111,165	9,517,871	100,011	21,130,168
Total.					53,950,980

It is apparent from the above table that there is room for expansion in the export traffic of the Kansas City Southern Railway, which would mean additional tonnage at very low rates, but, nevertheless profitable, because of the preponderance of southbound empty car movement. When the traffic becomes *Balanced*—and it lacks less than an additional train to make it so over the major portion of the road—the question of export grain traffic will be a serious one, for the margin of profit, already too narrow, will be materially reduced and with an increasing preponderance of southbound traffic wiped out entirely. It would be possible to make a calculation amounting almost to demonstration as to how this would happen; but when it is remembered that the existing margin between the rate received, about 3.2 mills per ton-mile, and the cost of movement, 2.83 mills per ton-mile, is only 0.37 of a mill per ton-mile, with preponderance of empty car mileage in a northbound (favorable) direction, no such demonstration will appear to be necessary.

In conclusion, there is this to be said:

First. The growth of traffic for many years to come will largely be southbound and made up principally of grain and grain products.

Second. The rates on this traffic are the lowest rates going, and with the introduction of inland water transportation, they are likely to be lower.

Third. The Kansas City Southern Railway cannot, on its present grades, with a preponderance of southbound traffic, handle the export grain traffic with profit.

Fourth. With grades reduced to the basis of 0.5 per cent, the present expense movement, 2.83 mills per revenue ton-mile, of the Kansas City Southern Railway can at least be cut in half and the road be placed in a position to handle the lowest classes of traffic offering at a profit.

Before entering upon the investigation of the matter of grade revision it will be well, for the benefit of those who do not care to go into the details of the investigation, to present briefly the conclusions reached therefrom. They are as follows:

#### CONCLUSIONS.

The investigation of the matter of the revision of grades and alignment of the Kansas City Southern Railway results in the determination of two lines of revision supplementing each other and which, in the order of their present importance and preference, are designated the line of "preferred revision" and the line of "ultimate revision"; and the adoption of a ruling gradient of 0.5 per cent (26.4 feet to the mile) as the one calculated to give the best results in cost of revision and in the future operation of the railway:

#### (FIRST) THE LINE OF "PREFERRED REVISION": GRADE REVISION JUSTIFIED.

(a) The line of "preferred revision" is shown on the attached Exhibits "A," "C(1)," "B," "C," "D," "E," "F," and "G" in red color. The length and cost of construction of the revisions and changes of operated road and the new line which are embraced in said line are given in the attached Exhibits 1, 2, 3, and 4, and are shown by the operating districts of the railway in the following statement:

#### Statement of line of "preferred revision" by operating districts.

Kansas City—Pittsburg	-----	(Lines 8 to 80, incl., Exhibit 1.)	
Revisions of Line	-----	20.59 miles	\$295,865. Cost.
Changes " "	-----	18.85 " "	\$601,596 " "
Total	-----	39.44 " "	\$897,461. " "
Pittsburg—Stillwell (Stillwell Junction)	-----	(Lines 2 to 7, incl., Exhibit 2.)	
	-----	(Lines 16 to 21, incl., Exhibit 2.)	
Revisions of Line	-----	4.70 miles	\$75,820. Cost.
Changes " "	-----	54.43 " "	1,780,505 " "
Total	-----	59.13 " "	1,856,325. " "
Stillwell (Stillwell Junction)—Mena	-----	(Lines 22 to 25, incl., Exhibit 2.)	
	-----	(Lines 57 to 69, incl., Exhibit 2.)	
Revisions of Line	-----	20.77 miles	\$263,903. Cost.
Changes " "	-----	9.33 " "	258,642. " "
New Line, (Including Stillwell Connection 3.5 miles)	-----	44.29 " "	1,847,305. " "
Total	-----	74.39 " "	2,369,850. " "

Mena—Shreveport .....	(Lines 4 to 16, incl., Exhibit 3.) (Lines 1 to 17, incl., Exhibit 4.)		
Revisions of Line .....	19.49 miles	\$225,492.	Cost.
Changes " " .....	50.13 " "	1,624,549.	"
Total .....	69.62 " "	1,850,041.	"
Shreveport—Leesville .....	(Lines 18 to 58, incl., Exhibit 4.)		
Revisions of Line .....	32.29 miles	\$358,625.	Cost.
Changes " " .....	23.49 " "	751,831.	"
New Line .....	5.08 " "	157,072.	"
Total .....	60.86 " "	1,267,528.	"
Leesville—Port Arthur .....	(Lines 59 to 80, incl., Exhibit 4.)		
Revisions of Line .....	14.18 miles	\$141,783.	Cost.
Changes " " .....	3.13 " "	91,882.	"
Total .....	17.31 " "	233,665.	"
Totals .....	320.75 miles	8,474,870.	Cost.

(b) The reduction of the grades of the Kansas City Southern Railway from the existing high ruling maximum gradients of from 1.0 per cent to 1.03 per cent to a uniform ruling gradient of 0.5 per cent on the line of "preferred revision" is justified as follows:

Total estimated cost of grade revision and establishment of main line via Ft. Smith (exclusive of change of terminals as shown in note of Table 4, below):

Revisions and changes of operated road .....	\$6,444,677
Establishment of main line via Ft. Smith .....	2,030,193
Total .....	8,474,870
Interest on above cost, at 5 per cent per annum .....	\$423,743
Estimated gross saving, per annum, from operation on reduced grade, with existing density of traffic .....	577,763
Estimated net saving, per annum, from operation on reduced grade .....	154,020

(c) An analysis of the line of "preferred revision" is shown by the following table:

TABLE 4.—Line of "preferred revision."

(Length of line, total estimated cost of construction and annual interest at 5 per cent per annum on the same, and comparative results from operation on the basis of 0.5 per cent ruling gradient. (See attached Exhibits "A," "A1," "A2," "B," "C," "D," "E," "F," and "G," and 1, 2, 3, and 4.)

Between	Line.	Length of line in miles.	Increase or decrease in length.	Total cost of construction.	Interest on cost at 5 per cent per annum.	Comparative results, operation.		
						Total annual gain.	Net loss.	Net gain.
Belt Junction—Pittsburg, ..	"(A1)"	118.28	Inc. 0.38	\$897,461	\$44,873	\$86,288	.....	\$41,415
Pittsburg—Stilwell Junction ..	"(A2)"	131.05	" 1.94	1,856,325	92,816	149,475	.....	56,659
Stilwell Junction—Spartan, ..	"(A1)"	56.94	" 3.70	2,030,193	101,510	114,088	.....	12,578
Spartan—Mena, .....	"(A1)"	68.46	" .29	339,657	16,983	48,079	.....	31,096
Mena—De Queen, .....	"(A1)"	57.54	" 3.62	1,410,526	70,526	54,150	\$16,376	
De Queen—Shreveport, .....	"(A1)"	125.98	" 1.21	439,515	21,976	41,545		19,569
Shreveport—Leesville, .....	"(A1)"	109.96	" .01	1,267,528	63,376	43,047	20,329	
Leesville—Port Arthur, .....	"(A1)"	117.36	Dec. .23	233,665	11,683	41,091		29,408
Belt Junction—Port Arthur, ..		758.54	Inc. 10.92	8,474,870	423,743	577,763	.....	154,020

NOTE. To the above total cost should be added \$225,000 for changing terminals, Pittsburg to Joplin, Mena to De Queen, and Hornbeck to Leesville. The change from Stilwell to Fort Smith \$100,000, is already included therein.

(d) By substituting in Table 4 above, line "(A4)" between Pittsburg and Stilwell, in place of line "(A2)," the following table is obtained, showing the effect of using Mallet road engines between Neosho and Stilwell and regular

road engines on line of "preferred revision" "(A4)," between Stilwell and Spiro via Stilwell Junction and Forth Smith:

TABLE 5.—Line of "preferred revision," modified by scheme "(A4)"—Use of Mallet road locomotives between Neosho and Stilwell.

[Length of line, total estimated cost of construction and annual interest at 5 per cent per annum on the same, and comparative results from operation on the basis of 0.5 per cent ruling gradient. (See attached Exhibits "A," "(A1)," "B," "C," "D," "E," "F," and "G," and 1, 2, 3, and 4.)]

Between—	Line.	Length of line in miles.	Increase or decrease in length.	Total cost of construction.	Interest on cost at 5 per cent per annum.	Comparative results, operation.		
						Total annual gain.	Net loss.	Net gain.
Belt Junction—Pittsburg....	"(A1)"	118.28	Inc. 0.38	\$897,461	\$44,873	\$86,288	.....	\$41,415
Pittsburg—Stilwell Junction....	"(A4)"	132.66	" 3.55	278,842	13,942	104,655	.....	90,713
Stilwell Junction—Spiro....	"(A1)"	56.94	" 3.70	2,030,193	101,510	114,088	.....	12,578
Spiro—Mena....	"(A1)"	68.46	" .29	339,657	16,983	48,079	.....	31,096
Mena—De Queen....	"(A1)"	57.51	" 3.62	1,316,526	70,526	54,150	\$16,376	.....
De Queen—Shreveport....	"(A1)"	125.98	" 1.21	439,515	21,976	41,545	.....	19,569
Shreveport—Leesville....	"(A1)"	109.96	" .01	1,267,528	63,376	43,047	20,329	.....
Leesville—Port Arthur....	"(A1)"	117.36	Dec. .23	234,665	11,683	41,091	.....	29,408
Belt Junction—Port Arthur....	.....	787.15	Inc. 12.99	6,897,387	344,869	532,943	.....	188,071

NOTE.—From the above total cost should be deducted \$100,000 for the Fort Smith terminal, the Stilwell terminal remaining unchanged, and to the above total cost should be added \$100,000, for changing terminals from Pittsburg to Joplin and Hornbeck to Leesville, the Mena terminal to remain as at present.

This scheme shows a net saving, per annum, of \$188,074, but on reference to Table 24, page 65, of comparison of schemes "(A1)," "(A2)," "(A3)," "(A4)," "(A5)," "(A6)," and "(A7)," between Pittsburg and Stilwell Junction and Stilwell, it will be seen that line "(A4)" does not gain so rapidly as "(A2)," and would fall behind it in from two to three years; moreover, the expenses of the intermediate terminal at Neosho and the cost of breaking up trains at both terminals would more than offset the advantage in saving. With this scheme, the terminal would remain at Stilwell, and the one at Mena would also remain unchanged.

(c) As a still further modification of the line of "preferred revision," the use of Mallet road locomotives may be introduced between Mena and Horatio, as shown by scheme "(A2)"—between Mena and Horatio—in the following Table 6:

TABLE 6.—Line of "preferred revision," modified by use of Mallet road locomotives—Scheme "(A4)" between Neosho and Stilwell and in scheme "(A2)" between Mena and Horatio.

[Length of line, total estimated cost of construction and annual interest at 5 per cent per annum on the same, and comparative results from operation on the basis of 0.5 per cent ruling gradient. (See attached Exhibits "A," "(A1)," "B," "C," "D," "E," "F," and "G," and 1, 2, 3, and 4.)]

Between	Line.	Length of line in miles.	Increase or decrease in length.	Total cost of construction.	Interest on cost at 5 per cent per annum.	Comparative results, operation.		
						Total annual gain.	Net loss.	Net gain.
Belt Junction—Pittsburg....	"(A1)"	118.28	Inc. 0.38	\$897,461	\$44,873	\$86,288	.....	\$41,415
Pittsburg—Stilwell Junction....	"(A4)"	132.66	" 3.55	278,842	13,942	104,655	.....	90,713
Stilwell Junction—Spiro....	"(A1)"	56.94	" 3.70	2,030,193	101,510	114,088	.....	12,578
Spiro—Mena....	"(A1)"	68.46	" .29	339,657	16,983	48,079	.....	31,096
Mena—Horatio....	"(A2)"	60.84	" 0.00	.....	.....	19,441	.....	19,441
Horatio—Shreveport....	"(A2)"	117.82	" 0.00	190,096	9,505	65,889	.....	56,384
Shreveport—Leesville....	"(A1)"	109.96	" .01	1,267,528	63,376	43,047	\$20,329	.....
Leesville—Port Arthur....	"(A1)"	117.36	Dec. .23	234,665	11,683	41,091	.....	29,408
Belt Junction—Port Arthur....	.....	787.15	Inc. 12.99	5,237,442	261,872	522,578	.....	360,706

NOTE.—From the above total cost should be deducted \$100,000 for the Fort Smith terminal, the Stilwell terminal to remain unchanged, and added \$150,000 for changing terminals from Pittsburg to Joplin and Hornbeck to Leesville, the Mena terminal to remain unchanged.

The result of this modification, as shown by the above Table 6, is an apparent gain from operation as compared with the line of "preferred revision," but the result as shown is more apparent than real, as the scheme would require the maintenance of an intermediate terminal and the breaking up of trains at each end of the Mallet districts, the expense of which would more than offset the apparent savings from operation.

(SECOND) THE LINE OF "ULTIMATE REVISION."

The line of "ultimate revision" consists of the further revision of the grades of operated road, as will ultimately be required, say, when the gross tonnage movement of the railway reaches twice or three times its existing density. These proposed ultimate changes are particularly described in paragraphs (a) and (b) following, and are shown on attached Exhibits "A," "A1," and "B" in green color.

(a) The first work of "ultimate revision" that will be required by the growing traffic of the railway is the revision of grades and alignment between Neosho, Mo., and Gravette, Ind. T., a distance of 36 miles operated road. The present ruling maximum grade of this section is 1.5 per cent (really 1.75 per cent account of uncompensated curvature, which, however, can be reduced at small cost to 1.5 per cent) and the cost of grade revision on the basis of 0.5 per cent, the uniform ruling gradient adopted for the railway throughout, is estimated at \$2,116,220.

So large an expenditure would be excessive in proportion to the existing density of traffic, and in view of the cost of the helper service that would be required to move the same in train loads corresponding to a 1.5 per cent grade, which cost is estimated at \$50,000 per annum. When, however, on account of the increased traffic, the cost of such helper service shall grow to \$105,841.00 the interest charge at 5 per cent per annum on the cost of revision as above, such revision will be justified and should be undertaken.

(b) The next work of "ultimate revision" that will probably be required to accommodate a largely increased volume of traffic will be an independent line between Belt Junction and milepost 30.26, a distance of 18.88 miles, in place of the joint use of the Frisco road between Belt Junction and Grandview as at present; the estimated cost of such a line is \$914,576.

On the basis of the present volume of traffic, in view of the low rental (about \$5,000 per annum) paid the Frisco Company for joint use of its road as above and the cost of helper service thereon required to move the traffic in uniform trainloads corresponding to a 0.5 per cent gradient, which cost would probably not amount to more than \$15,000 per annum, the building of an independent line is not now justified. But with an increase of, say, 125 per cent in the present volume of traffic, a corresponding increase in cost of helper service, and with the congestion of traffic that would ensue from the probable material increase of the traffic of the Frisco Company, the building of the independent line with a 0.5 ruling gradient would no doubt be fully justified.

(c) North of De Queen the lowest practicable gradient obtainable is 0.5 per cent, but south of De Queen a 0.3 per cent ruling gradient can be provided for an expenditure of \$1,948,576 over the cost of a 0.5 per cent grade. The expenditure required for a 0.3 per cent ruling gradient south of De Queen, however, is not justified by the existing volume of traffic, nor will it be fully justified until the traffic density of the railway shall require a second track for its proper accommodation, in which case the Kansas City Southern Railway's revised main line, Kansas City to De Queen, embracing three operating districts, would have a 0.5 per cent ruling gradient, and from De Queen to Port Arthur, also embracing three operating districts, would have a 0.3 per cent ruling gradient.

(THIRD) RULING GRADIENT. 0.5 PER CENT BEST ADAPTED FOR GRADE REVISION.

(a) A ruling gradient of 0.5 per cent (2.64 feet per mile) is the one best adapted to the revision of grades of the Kansas City Southern Railway between Kansas City and Port Arthur.

(b) It is the lowest ruling gradient compatible with little or no permanent duplication of operated road; a 0.3 per cent ruling gradient, on the other hand, would require the permanent duplication of operated road most of the way from Kansas City to De Queen, Arkansas, a distance of about 433 miles.

(c) A ruling gradient of 0.5 per cent would only increase the length of operated road between Kansas City and De Queen, Ark., 10.92 miles, or 2.72 per cent. The length of line between the same points on a 0.3 per cent ruling gradient would be at least 10 miles greater, or 12.03 per cent. Between De Queen and Port Arthur a 0.5 per cent ruling gradient would increase the length

of the operated road 0.99 mile, or 0.28 per cent, while a 0.3 per cent ruling gradient would increase the length 6.72 miles, or 1.9 per cent.

(d) The total estimated cost of "preferred revision" on the basis of a 0.5 per cent ruling gradient between Kansas City and De Queen is \$6,534,162, or at the rate of \$15,000 per mile of operated road. The cost of building a new line on a 0.3 per cent ruling gradient between the same points would certainly not be less than \$35,000 per mile of line, and probably would exceed \$40,000 per mile. From De Queen to Port Arthur the cost of revision on the basis of a 0.5 per cent ruling gradient would be \$1,940,708, or at the rate of \$5,513 per mile of operated road, and the cost of revision on the basis of a 0.3 per cent ruling gradient \$3,886,264, or at the rate of \$11,000 per mile of operated road.

(e) The comparisons of paragraphs (c) and (d) between a ruling gradient of 0.5 per cent and one of 0.3 per cent may be tabulated as follows:

TABLE 8.

Ruling gradient	Excess length, miles.		Kansas City and De Queen.		De Queen and Port Arthur.		Total cost.
	Kansas City De Queen	De Queen Port Arthur	Cost	Cost per mile operated road.	Cost	Cost per mile operated road.	
0.5%	19.92	0.99	\$6,534,162	\$15,000	\$1,940,708	\$5,198	\$8,474,870
0.3%	55.90	6.72	17,138,800	39,581	3,886,264	10,825	21,025,064

(f) The total estimated cost of ruling gradient of 0.5 per cent, as appears from the above Table 8, excluding cost of change of the three terminals, Pittsburg, Mena, and Hornbeck as above, is \$8,474,870, all of which expenditure is justified by the present volume of traffic. On the other hand, a ruling gradient of 0.3 per cent would cost \$21,025,064, of which \$17,138,800, representing the cost of the 0.3 per cent line from Kansas City to De Queen, could not be justified by the traffic, and the balance, \$3,886,264, would require several years for its justification, and when justified the 0.5 per cent ruling gradient could be reduced to a 0.3 per cent gradient.

(g) A ruling gradient of 0.5 per cent will permit of placing Fort Smith on the revised main line of the Kansas City Southern Railway, which is altogether impracticable with a ruling gradient of 0.3 per cent.

(h) A ruling gradient of 0.5 per cent, with an average loading of 25 tons to the car, an average weight of car of 20 tons, and with an average train content of empty cars, will permit of handling from 50 to 65 cars per train, which is a practical everyday limit to the size of the average train for a western single-track railway.

The 0.5 per cent ruling gradient adopted for the purpose of this investigation is supplemented, wherever practicable, by train momentum due to velocities ranging from 10 to 30 miles per hour, according to the physical conditions of the line. While the writer is inclined to the use of straight grades, certainly wherever the lay of the ground and density of traffic both combine to justify it, he favors the use of momentum grades where otherwise grade revision might be impracticable or indefinitely delayed.

The grades as laid for the proposed revision of the Kansas City Southern Railway will permit of an average speed of from 15 to 18 miles per hour for through freight trains with full loading, with a maximum and minimum speed of 30 and 10 miles per hour, respectively, at the bottom and top of ruling gradients.

The foregoing conclusions are recapitulated as follows:

#### RECAPITULATION.

First. The revision of grades and alignment of the Kansas City Southern Railway on the line of "preferred revision" is fully justified as follows:

Total estimated cost of grade revision and establishment of main line via Ft. Smith (exclusive of change of terminals as shown in note to Table 4 above):

Revisions and changes of operated road	\$6,444,677
Establishment of main line via Ft. Smith	2,030,193
Total	\$8,474,870



Interest on above cost at 5 per cent per annum	8423, 743
Estimated gross saving, per annum, from operation on reduced grade, with existing density of traffic	577, 763
Estimated net saving, per annum, from operation on reduced grade	154, 020

Second. The ruling gradient of 0.5 per cent is the one best adapted for grade revision of the main line of the Kansas City Southern Railway. A ruling gradient of 0.3 per cent is impracticable between Kansas City, Mo., and De Queen, Ark., by reason of excess length and duplication of line. South of De Queen a 0.3 per cent ruling gradient is practicable, but is not justified by the existing volume of traffic, nor will it be fully justified until the traffic density of the railway shall require a second track for its proper accommodation.

Third. The grade revision on the line of "preferred revision" should be begun at once and diligently prosecuted in order that the Kansas City Southern Railway may fortify itself as against the aggressive development of its powerful neighbors and competitors and in order that it may be able to handle at a profit the great volume of agricultural products offering at Kansas City and may rapidly develop its coal and other low-grade tonnage resources.

Fourth. The commanding position and rapid growth of Fort Smith, Ark., make it essential that the Kansas City Southern Railway establish its main line through Fort Smith, and also locate its division terminals in that city, and this is a matter of such prime importance that it should be given immediate attention.

The discussion of grade revision together with the statistics and comparisons upon which the above conclusions are based are found in the body of this report, following.

Respectfully submitted,

HORACE G. BURT.

CHICAGO, ILL., June 25, 1907.

#### DISCUSSION OF PROPOSED REVISION OF GRADES AND ALIGNMENT OF THE KANSAS CITY SOUTHERN RAILWAY.

The object of grade revision is to effect a reduction in the cost of railway operation by increasing the trainload and correspondingly decreasing the number of trains required to move a given traffic. The same results, within certain limits, may be obtained by an increase in the tractive power of the locomotives employed and when both means are employed together, the most effective results are obtained.

The adoption of any scheme of grade revision is dependent upon several factors, the most important of which are: First, the physical characteristics of the territory to be traversed; second, the density of traffic to be moved; the former as affecting the practicability and cost of revision, the latter as furnishing the justification therefor. It would perhaps be more suitable to reverse the order of these factors, for with a density of traffic sufficiently large, physical obstacles may generally be largely overcome. Both of the above factors in the case of the Kansas City Southern Railway are known, the latter being derived from traffic statistics of the railway company, the former having been ascertained by examinations and instrumental surveys of the territory made during the past year.

The economic basis of grade revision is the increased trainload which results in a saving of train-miles; but grade revision frequently involves changes and duplication of line which materially affect the relative length of road to be operated and to that extent the net saving of train-miles, and in such cases curvature and rise and fall, which count in the net results of revision, are also affected. In order, therefore, to determine the net results of grade revision, the several elements of cost which enter into and affect it must be determined, and to these elements must be assigned proper values, "per train-mile," or "per train" and "per mile of road," etc., per annum.

The operating expenses of a railway are usually divided into two classes, viz: Fixed and movement expenses, terms which are sufficiently self-explanatory. The movement expenses, with which grade revision is principally concerned, are subdivided into "freight" and "passenger," and these again are still further subdivided into the several classes corresponding with the different departments of railway operation and maintenance. The unit of measure for movement expenses is the "train-mile," and the several units of cost are determined thereby. The following table gives the units of cost "per train-mile" of

the Kansas City Southern Railway, based on statistics of actual operation and maintenance:

TABLE 9.—Units of cost per train-mile and per mile of road of the Kansas City Southern Railway, based on statistics of actual operation for the year ending March 31, 1907.

Movement expenses.	Cost, cents per train-mile.			
	Northern division.		Southern division.	
	Freight.	Pass.	Freight.	Pass.
Station service.....	2.84	0.35	3.65	0.38
Yard service.....	4.32	—	5.11	—
Fuel for locomotives—switch.....	2.42	—	2.60	—
Fuel for locomotives—road.....	18.51	8.25	17.59	8.40
Train service.....	11.41	10.07	11.41	10.56
(A) Engine service (except fuel).....	16.40	9.22	14.99	8.50
Wear and tear of road.....	5.78	4.48	9.41	7.58
Wear and tear of equipment.....	21.64	13.82	17.74	10.69
Accidental expenses.....	7.18	4.63	8.30	4.26
Total specific cost per "train-mile", .....	90.50	50.82	90.80	50.29

The above (A) cost per "train-mile" is applicable to service "put on" on important changes and duplications of line, which involve new stations and business, and also to the total abandonment of service on any line of like extent or importance.

Fuel for locomotives—Road.....	18.51	8.25	17.59	8.40
Train service.....	11.41	10.07	11.41	10.56
Engine service (except fuel).....	16.40	9.22	14.99	8.50
(B) Wear and tear of road.....	5.78	4.48	9.41	7.58
Wear and tear of equipment.....	21.64	13.82	17.74	10.69
Accidental expenses.....	7.18	4.63	8.30	4.26
Limited specific cost per "train-mile" .....	80.92	50.47	79.44	49.41

The above (B), cost per "train mile," is applicable to unimportant changes and to revisions, of line, involving no additional station service or business; and also to the transfer of a train from one line to another, in cases where the station service, yard service or fuel for locomotives (switch), on the line transferred from, are not affected by such transfer; but when such items are affected by transfer, allowance should be made therefor.

Fuel for locomotives—Road.....	50% total cts.	9.26	8.79
Train service.....	100% " "	11.41	11.41
(C) Engine " (except fuel).....	100% " "	16.40	14.99
Wear and tear of road.....	50% " "	2.89	4.71
" " " equipment.....	50% " "	10.82	8.87
Accidental expenses.....	50% " "	3.59	4.15
Specific cost per "train-mile" saved by reduction of grades, cts.		54.37	32.92

The above (C), cost per "train mile," is applicable to the train miles saved as a result of grade reduction.

(D) Train service.....	100% total cts.	11.41	11.41
Engine " .....	100% " "	16.40	14.99
Specific cost per "train-mile" saved by increased tractive power.....		27.81	26.40

The above (D), cost per "train-mile," is applicable to the train miles saved by using increased tractive power.



## KANSAS CITY SOUTHERN RAILWAY COMPANY VS.

## VOLUME, CHARACTER, AND DISTRIBUTION OF TRAFFIC.

The traffic of the Kansas City Southern Railway consists of two classes of freight, viz. revenue and nonrevenue or company. These two classes constitute the net tonnage, the volume of which as given in the annual statistics of the railway is shown in Table 11 below for five years ending June 30, 1906.

TABLE 11.—Comparative statement of net tonnage, the Kansas City Southern Railway, five years ending June 30th, 1906.

Tonnage.	1902	1903	1904	1905	1906	Per cent inc. or dec. compared with year 1901					Av. inc. per yr.
						1902	1903	1904	1905	1906	
	<i>Tons.</i>	<i>Tons.</i>	<i>Tons.</i>	<i>Tons.</i>	<i>Tons.</i>						
Revenue.....	2,038,843	2,198,646	2,320,127	2,472,811	2,776,747	10.32	18.97	25.55	33.81	50.03	10.05
Company.....	656,096	591,826	561,703	547,549	892,062	4.57	5.52	10.33	12.59	42.40	8.48
Total.....	2,694,939	2,790,472	2,881,830	3,020,360	3,668,809	8.91	12.77	16.46	22.06	48.27	9.66

From the above table it appears there was an increase of 48.27 per cent in net tonnage for the year 1906 as compared with the year 1901, due to 50.03 per cent increase in revenue and 42.40 per cent in company freight. The average yearly increase in net tonnage for the five years was 9.66 per cent, due to 10.05 per cent increase in revenue and 8.48 per cent in company freight. The amount and percentages of revenue tonnage, by classes of commodities, are shown in the following Table 12 for the five years ending June 30th, 1906.

TABLE 12.—Classified revenue tonnage, the Kansas City Southern Railway, five years ending June 30th, 1906.

Products of—	Total tons.					Per cent.				
	1902	1903	1904	1905	1906	1902	1903	1904	1905	1906
Agriculture.....	374,899	395,220	355,413	358,381	477,623	18.34	17.97	15.33	14.99	17.22
Animals.....	37,448	43,455	58,374	49,046	54,794	1.84	1.97	2.51	1.98	1.98
Mines.....	404,976	516,695	487,109	604,394	516,864	19.87	23.50	21.00	24.44	18.61
Forests.....	926,661	931,015	1,069,524	1,119,314	1,255,314	45.46	42.35	47.39	45.27	45.20
Manufactures.....	181,752	179,835	167,012	176,044	271,209	8.94	8.18	7.19	7.12	9.75
Miscellaneous.....	113,127	132,426	152,695	165,612	200,943	5.55	6.03	6.58	6.70	7.24
Total.....	2,038,843	2,198,646	2,320,127	2,472,811	2,776,747	100.00	100.00	100.00	100.00	100.00

It is apparent from Table 12 that the growth of the total tonnage during the years given, has been comparatively uniform and steady. As compared with the year 1901 the average rates of increase for five years for the several classes are as follows:

	Per cent.
Agriculture.....	8.25
Animals.....	4.99
Mines.....	4.62
Forests.....	8.51
Manufactures.....	60.79
Miscellaneous.....	20.80

The total average being 10.95 per cent as given in Table 11. For the year 1906 the comparison with the previous year and the year 1901 was as follows:

TABLE 13.—*Comparative statement of revenue commodities for the year 1906, as compared with the years 1905 and 1901.*

Commodities.	1905	1906	1901	Percentages of inc. or dec. of 1906.	
				Over 1905.	Over 1901.
Agriculture.....	477,623	358,381	338,186	33.27	41.25
Animals.....	54,794	49,046	43,857	11.71	24.93
Mines.....	516,864	604,394	419,824	14.48	23.11
Forests.....	1,255,314	1,119,334	880,531	12.14	42.56
Manufactures.....	271,508	176,044	67,138	54.06	304.96
Miscellaneous.....	200,943	165,612	98,492	21.33	104.01
Total.....	2,776,747	2,472,811	1,848,028	12.29	50.05

From the foregoing analysis it appears:

First. That the revenue traffic of 1906 was 50.03 per cent heavier than in 1901.

Second. That the average growth of revenue traffic during the above five-year period was comparatively uniform, steady, and at the rate of 10.05 per cent per annum, and the actual growth from 1905 to 1906, 12.29 per cent.

Third. That all classes of commodities, except products of mines, showed material growth in the year 1906 over the year 1905 and any previous year; products of animals fell a little below the level of the year 1901, while products of mines dropped back to near the level of the year 1903.

Now while it is impossible to predict with certainty what the future course of traffic on the Kansas City Southern Railway will be, it is reasonable to assume that the average rate of growth, which has obtained during the five years, 1901 to 1906, can under ordinary conditions be maintained; and that with materially enlarged and improved facilities and corresponding service the rate of growth from 1905 to 1906 is equally reasonable of assumption.

#### GROSS TONNAGE.

In the working out of grade revision the net tonnage needs to be supplemented by the weight of equipment (freight cars) in which it is transported, in order to meet the actual conditions of operation. This combined tonnage is called the gross tonnage of the railway. Table 14 below gives the gross tonnage as constituted during the years 1902 to 1906, inclusive:

TABLE 14.—*Comparative statement of gross tonnage, the Kansas City Southern Railway, five years ending June 30th, 1906.*

Tonnage.	1902		1903		1904		1905		1906	
	Tons.	Per cent.	Tons.	Per cent.	Tons.	Per cent.	Tons.	Per cent.	Tons.	Per cent.
Revenue tonnage.	2,038,843	39.40	2,198,646	39.58	2,320,127	39.08	2,472,811	38.19	2,776,747	37.11
Company " "	655,066	12.66	591,826	10.65	561,703	9.46	547,549	8.46	892,062	11.92
Equipment " "	2,481,052	47.94	2,764,965	49.77	3,055,283	51.46	3,454,304	53.35	3,814,437	50.97
Total " "	5,174,961	100.00	5,555,437	100.00	5,937,113	100.00	6,474,664	100.00	7,483,246	100.00

*Per cent of increase or decrease compared with the year 1901.*

Tonnage.	1901, tons.	1902		1903		1904		1905		1906	
		Inc.	Dec.	Inc.	Dec.	Inc.	Dec.	Inc.	Dec.	Inc.	Dec.
Revenue.....	1,848,028	10.32	.....	18.97	.....	25.55	.....	33.81	.....	50.03	.....
Company.....	626,437	4.57	.....	5.52	.....	10.33	.....	12.59	.....	42.40	.....
Equipment.....	2,325,610	6.68	.....	18.88	.....	31.38	.....	48.53	.....	64.02	.....
Total.....	4,800,075	7.81	.....	15.73	.....	23.69	.....	34.88	.....	55.90	.....

Average increase per year:

	Per cent.
Revenue .....	10.05
Company .....	8.48
Equipment .....	12.80
Total .....	31.18

In the statement of gross tonnage above it will be noticed that equipment tonnage constitutes 50.97 per cent of the total in the year 1906, having declined from 53.35 per cent in 1905 and 51.46 per cent in 1904. The explanation of the high percentage of equipment tonnage lies for the most part in the excess of empty car mileage south-bound to provide for northbound loading. This condition is clearly shown in Table 15 following:

TABLE 15.—Comparative statement of loaded and empty freight car mileage, the Kansas City Southern Railway, five years ending June 30th, 1906.

Mileage of cars.	1902		1903		1904		1905		1906	
	Car miles.	Per cent.	Car miles.	Per cent.	Car miles.	Per cent.	Car miles.	Per cent.	Car miles.	Per cent.
Loaded cars, north.	17,247,534	40.85	20,157,563	41.43	22,776,491	41.27	24,434,009	42.48	25,099,676	41.09
Empty " "	3,716,873	8.80	4,317,912	8.88	4,295,716	7.78	3,604,600	6.27	4,182,728	6.69
Total " "	20,964,407	49.65	24,475,475	50.31	27,072,207	49.05	28,038,609	48.75	29,282,404	47.78
Loaded cars, south.	15,142,230	35.85	15,769,632	32.48	15,569,637	28.21	14,614,295	25.40	20,357,229	32.51
Empty " "	6,119,037	14.50	8,417,131	17.21	12,549,392	22.74	14,867,812	25.85	12,314,022	19.60
Total " "	21,261,267	50.35	24,186,763	49.69	28,119,029	50.95	29,482,107	51.25	32,671,251	52.11
Total cars, D. & S.	42,225,674	100.00	48,662,238	100.00	55,191,236	100.00	57,520,716	100.00	61,953,655	100.00

The ideal condition would be a *balance* of loaded car mileage in both directions, but that is rarely obtained or long maintained in actual operation, especially where there is any decided growth in volume of one or more of the principal commodities transported, as grain, grain products, coal, lumber, etc. Another cause for the relative increase in equipment tonnage was the increase in the average weight of freight cars, amounting to approximately 14 per cent during the five years ending June 30th, 1906; the weight figured for the Kansas City Southern Railway is as follows:

	Tons, average weight.
1901 .....	14.5
1902 .....	14.5
1903 .....	15.0
1904 .....	15.5
1905 .....	16.0
1906 .....	16.5

This average weight (and capacity) has increased in a greater ratio than either the load per loaded car or per loaded and empty car of revenue and company freight as shown by the following table:

TABLE 16.

Year.	1901	1902	1903	1904	1905	1906	Av. inc. per year compared with 1901.
Tons to each loaded car revenue and company freight.	20.46	20.53	20.51	21.04	20.61	21.56	Per cent. 1.07
Tons to each loaded and empty car revenue and company freight.	14.89	15.75	15.14	14.62	13.99	15.87	1.31
Ratio of weight of empty car.	14.5	14.5	15.0	15.5	16.0	16.5	2.76
per cent.	70.87	70.62	73.13	73.67	77.63	76.33	1.59
Ratio of weight of car to load of loaded and empty car.	97.38	92.06	90.07	106.02	114.37	103.97	1.35
per cent.							

It is not unlikely the average weight of freight cars will continue to increase at the same or an accelerated ratio up to an average of 20 tons, until the old small capacity equipment is worn out or becomes obsolete. In the matter of car loading, it is improbable that the average of loaded car loading, on account of mixed character of traffic, will increase in a much greater ratio than heretofore or rise much, if any, about 25 tons finally.

## DISTRIBUTION OF TONNAGE.

For the purpose of arriving at a basis of gross tonnage to be used in the working out of grade revisions we may take the gross tonnage movement of the road for a period of three years, 1905 to 1907, inclusive (May and June of 1907 being estimated), and from the average rate of increase in the same, by the several districts, estimate the gross tonnage movement for the year 1908, as follows:

TABLE 17.—Comparative statement of gross tonnage tons one mile per mile of road, yearly and daily, showing the tonnage movement northbound and southbound by districts, of the Kansas City Southern Railway for the years 1905 to 1907, inclusive, and an estimate for the year 1908.

	1905		1906		1907		1908 estimated.
	N. B.	S. B.	N. B.	S. B.	N. B.	S. B.	
<b>Kansas City-Pittsburg</b> (125.4 miles):							
Yearly.....	1,708,565	1,941,710	1,792,922	1,403,578	1,971,257	1,586,521	.....
Daily.....	4,681	5,854	4,912	3,845	5,401	4,347	.....
Average.....	3,768		4,379		4,874		5,427
<b>Pittsburg-Stilwell</b> (129.2 miles):							
Yearly.....	1,448,320	1,020,905	1,529,501	1,352,471	1,673,508	1,556,554	.....
Daily.....	3,968	2,797	4,190	3,705	4,585	4,295	.....
Average.....	3,384		3,948		4,425		4,946
<b>Stilwell-Mena</b> (121.4 miles):							
Yearly.....	1,414,375	1,114,345	1,612,700	1,592,328	1,676,551	1,693,514	.....
Daily.....	3,875	3,053	4,119	4,363	4,563	4,393	.....
Average.....	3,464		4,391		4,493		5,008
<b>Mena-Shreveport</b> (178.1 miles):							
Yearly.....	1,306,335	1,145,370	1,423,730	1,421,247	1,440,813	1,434,970	.....
Daily.....	3,579	3,138	3,901	3,894	3,947	3,931	.....
Average.....	3,358		3,898		3,939		4,230
<b>Shreveport-Hornbeck</b> (94.1 miles):							
Yearly.....	1,329,340	821,250	1,297,557	870,229	1,278,226	1,036,887	.....
Daily.....	3,642	2,250	3,555	2,386	3,562	2,841	.....
Average.....	2,946		2,971		3,172		3,285
<b>Hornbeck-Port Arthur</b> (134.0 miles):							
Yearly.....	664,280	433,620	597,340	645,831	708,331	850,935	.....
Daily.....	1,772	1,188	1,637	1,769	1,941	2,331	.....
Average.....	1,230		1,703		2,136		2,589
<b>Kansas City-Port Arthur</b> (282.2 miles):							
Yearly.....	1,271,564	943,781	1,372,981	1,214,565	1,455,833	1,356,286	.....
Daily.....	3,484	2,586	3,792	3,382	3,989	3,719	.....
Average.....	3,035		3,572		3,854		4,264

It appears from the above table that the gross tonnage movement while varying considerably in volume by divisions, Kansas City to Mena and Mena to Port Arthur, varies much less in volume northbound and southbound by districts, the preponderance showing slightly northbound. For the purposes of grade revision the tonnage movement is practically *balanced*, as less than an average revision would throw the balance of tonnage in either direction. There is no way of ascertaining definitely what the future course of the tonnage movement will be, but the probabilities are the southbound movement will gradually gain on the northbound and in the end preponderate—perhaps largely.

The lumber movement which has furnished the preponderance of northbound tonnage has probably reached its maximum, but the development of the country will supply other commodities to measurably take its place, perhaps on shorter hauls; but as already stated the southbound is likely in the end to preponderate. While this may be the case, the change in the movements will be gradual and the prospect hardly warrants an attempt at anticipating the future. The best plan is to take an average of the movements northbound and southbound and this has been done in the table above, the estimated average daily tonnage for the year 1908 being assumed as the basis for grade revision.

PHYSICAL CHARACTERISTICS OF THE MAIN LINE OF THE KANSAS CITY SOUTHERN RAILWAY AND ADJACENT TERRITORY: PHYSICAL CHARACTERISTICS, ESTIMATED COST OF CONSTRUCTION, AND COMPARATIVE OPERATING RESULTS OF PROPOSED LINES OF GRADE REVISION.

The main line of the Kansas City Southern Railway, closely following the western boundary of the first tier of trans-Mississippi States extends from the Missouri River at Kansas City to the Gulf of Mexico at Port Arthur, a distance of 786 miles. For a distance of 600 miles from Kansas City it traverses the watershed of the Mississippi River in the drainage areas of the Missouri, Arkansas, and Red Rivers, leaving which it crosses over into the valley of the Sabine River, thence into the valleys of the Calcasieu and the Houston Rivers and back into the valley of the Sabine, which latter it follows to the Gulf. The physical characteristics of the Kansas City Southern Railway, corresponding generally with those of above drainage areas, are given in the following Table 18:

TABLE 18.—Physical characteristics main line, the Kansas City Southern Railway, Kansas City to Port Arthur.

District.	Length.	Rul'g grade		Curvature.			Rise and fall.	
		Rate		Max. rate	Total	Av. deg. per mile.	Main line.	Feet.
		South.	North.					
	<i>Miles.</i>			<i>%</i>	<i>Deg's</i>	<i>%</i>		
Kansas City—Pittsburg	129.2	1.00	1.00	6	2,894	22.4	20.0	1,797
Total	129.2			6	2,894	22.4	20.0	1,797
Pittsburg—Neosho	44.9	1.00	1.00	6	1,353	25.7	18.9	315
Neosho—Day	59.4	1.61	1.56	6	3,062	51.6	35.7	1,174
Day—Stilwell	24.9	1.00	1.00	6	785	31.5	24.8	374
Total	129.2			6	5,000	38.7	27.8	2,063
Stilwell—Heavener	79.6	1.00	1.00	6	2,493	31.3	22.5	1,017
Heavener—Mena	41.8	1.50	1.35	6	1,929	46.8	37.1	1,021
Total	121.4			6	4,422	39.6	27.6	2,038
Mena—Horatio	60.8	1.35	1.35	6	4,415	72.6	37.8	1,364
Horatio—Shreveport	117.8	1.00	1.00	4	1,905	14.8	15.0	1,155
Total	178.6			6	6,320	33.7	32.6	2,519
Shreveport—Hornbeck	93.5	1.00	1.00	4	2,101	22.5	17.3	1,054
Total	93.5	1.00	1.00	4	2,103	22.5	17.3	1,054
Hornbeck—DeRidder	37.1	1.00	1.00	4	1,049	28.4	21.9	327
DeRidder—Port Arthur	96.9	0.30	0.30	3	498	4.1	4.8	415
Total	134.0			4	1,547	11.6	9.5	942
Kansas City—Port Arthur	786.0	1.63	1.56	6	22,016	28.0	20.9	10,413



NOTE. The following exceptions exist to the maxima of gradient and curvature given in the table above:

*Exceptions to the maxima of gradient and curvature given in the table above.*

District.	Length.	Curvature.	Gradients.
Kansas City-Pittsburg.			Percent.
Helper grade north of Granby new	miles 4.72		1.63
width limits of Pittsburg.	feet 256	7.30	
" " " " "	feet 562	7.00	
Pittsburg-Spiville.			
M. P. 155 and 156.	" 4.00		1.47
" 158.5 and 159.7.	" 4.00		1.34
Newburg-top of hill.	miles 4		1.75
Casselman-Anderson.	" 8		1.75
M. P. 179.7.	feet 540	10	
" " "	" 250	8	
Suncoast-Hornbeck.			
M. P. 349.5.	" 4.577	5	
" 350.	" 1.754	5.20	
Ridder-Port Arthur.			
City limits-Desamont.	" 4.120	8	
Free short-passes velocity.	" 1.39	7	1.65 and 1.2
M. P. 385.	" 1.39	7	

The physical characteristics shown in the above table are best illustrated and understood by reference to the profiles or vertical sections of the operated road. (See attached Exhibits "A," "B," "C," "D," "E," "F," and "G.")

Upon examination of the attached exhibits, it is seen that the operated road traverses sections of country which differ widely in respect to general elevation and superficial contour. For the purposes of grade revision, these sections may be classed according to their prevailing maximum gradients as follows:

Section (1) Kansas City to Pittsburg.....129.2 miles.....1.00%.....	Ruling gradient
" (2) Pittsburg to Spiro.....182.4 ".....1.61% S. B., 1.50% N. B.,.....	"
" (3) Spiro to Horatio.....129.0 ".....1.50% S. B., 1.55% N. B.,.....	"
" (4) Horatio to Port Arthur.....345.4 ".....1.00%.....	"

By Mr. UNTERMYER:

Q. When was this work of grade revision begun?—A. I think we let the contracts in the summer of 1909.

By Mr. NEEDHAM:

Q. What do you mean by "the summer"?—A. It is not clearly in my mind just when it was begun, but I think—

Q. (Interrupting.) It is stated in your petition, is it not?

By Mr. UNTERMYER:

Q. The summer is a pretty well defined proposition. You can not give the exact day of the month, can you?—A. I do not remember the exact date.

Q. In July or August, wasn't it?—A. Somewhere along there.

Q. That is when the actual contracts for the work were made?—A. Yes, sir.

Mr. NEEDHAM. As this is being offered for the purpose of showing its relation to the time of the promulgation of this order, it is quite important that the exact date be given, and, of course, it can be given from the contract itself.

The COURT. The averment is "about August 25."

Mr. NEEDHAM. That is the averment in the petition.

Mr. UNTERMYER. When we had notice of this order; yes.

Mr. NEEDHAM. No; you state the notice of the order as August 16th, and the contract was dated August 25, according to your petition.

The COURT. The petition says, "On or about August 25, 1906 caused contracts to be let for revision of the grade," etc.

By Mr. UTERMYER:

Q. Prior to that time you had been committed to these improvements?—A. Oh, yes.

Q. And you had your money borrowed?

Mr. NEEDHAM. We object to that prior question. If you mean by that committed to the contractors—

Mr. UTERMYER. No; I did not mean that; I mean committed to the people from whom the money had been obtained for the specific purpose of making these specific improvements.

The COURT. Let him answer that with relation to the explained interrogatory of Mr. Utermyer.

By Mr. UTERMYER:

Q. That is the fact, is it not?—A. Yes, sir.

Q. The bonds had been sold?—A. Yes, sir.

Q. And the money had been paid in?—A. Yes, sir.

Q. And was available for those specific purposes?—A. Yes, sir.

Q. You understood it could be used for those purposes and none other?—A. Yes, sir.

Q. The interest on those bonds had been running from the 1st of July, had it not?—A. Yes, sir.

Q. You had understood the bankers had distributed the bonds and sold them and scattered them among their customers, and those bonds were running with interest and you had the money?—A. Yes, sir.

Q. And that had been the condition since the 1st of July?—A. Yes, sir.

Q. There were two ways which presented themselves of making the grade revisions, were there not?—A. There were; yes, sir.

Q. Will you be good enough to explain just what they were and why one was adopted rather than the other, and explain it quite as fully as you can?—A. It would have been physically possible to have made these changes on the then right-of-way by raising and lowering the track, or it was physically possible to affect the reduction of grade by new location in the immediate vicinity. The determining reason for adopting the latter instead of the former course was the expense involved in doing it. It was very much cheaper to do the work by change in the location.

By the COURT:

Q. Were they both suggested to the organization through the report of Mr. Burt, or did he limit his views to the one finally adopted?—A. He limited his views to the one finally adopted.

By Mr. UTERMYER:

Q. He stated the reasons, did he not?—A. Yes, sir.

By Mr. NEEDHAM:

Q. I would like to ask whether you mean that is in the report there?—A. A discussion of the two methods?

Q. Yes.—A. Not at all.

Q. It was not in the report?—A. No; he just discussed the cheapest method of doing it.

By Mr. UNTERMYER:

Q. You had gone over the line of road?—A. Yes, sir.

Q. And you had determined for yourself in what way it should be done?—A. Yes, sir.

Q. Did your determination coincide with that of Mr. Burt?—A. It did.

Q. You knew, did you not, as an engineer and as a practical railroad man of experience that both those ways were available?—A. Yes, sir.

Q. Did you determine what would be the difference in cost between using the right of way and line of the old road and making a new right of way, as you say?—A. It was approximately determined.

Q. What was the difference? The engineer is here, however, is he not?—A. Yes, sir.

Q. Who was the engineer in charge of that work?

No response.

Q. You are personally aware of the difference in cost, are you not?—A. Yes, sir.

Q. What was the difference in cost?—A. My recollection is that it was almost twice as expensive to do the work on the right of way as to do it off the right of way.

Q. Would you mind explaining why that was so?—A. There was a greater quantity of material to be moved to do it—earth and rock.

Q. The cost of doing it on the old right-of-way was \$1,230,318.99, was it not?—A. That is right; yes, sir.

Q. And the estimated cost of doing it in the way in which it was done was how much?—A. \$629,399.71.

Q. And that is the way it turned out, is it not?—A. Yes, sir.

Q. I mean it was done for the estimated amount?—A. Yes, sir.

Q. Should you say it was just as serviceable for its purpose, or more or less so, than if the grade reduction had been made upon the line of the old road?—A. I should say it was just as serviceable.

Q. And had just as great value?—A. Yes, sir.

Q. To what extent did this improvement cheapen the cost of operation?—A. Just about cut it in half.

By the Court:

Q. Your total cost of operation?—A. The cost of train movement.

Q. Train movement?—A. Yes, sir.

By Mr. UNTERMYER:

Q. How many miles of road did this grade revision embrace?—A. It covered 41 per cent; it enabled the operation of the road on a low-grade basis for 41 per cent of its length.

Does this statement show the exact mileage covered by the grade reduction. I show you Exhibit A attached to the petition in this case.—A. Yes, sir.

Mr. UNTERMYER. I offer in evidence Exhibit A attached to the petition in this case.

The Exhibit A referred to is in the words and figures following:

PETITIONER'S EXHIBIT No. 1

EXHIBIT A

Old line abandoned	New line constructed	Cost of reference old line to 0.5% grade	Cost of replacing in kind old line abandoned	Cost of constructing new line with new material	Salvage from aban. done	Estimated cost of constructing new line using old material	Value of old material retained	All other costs
					line not used in construction of new line			
Between M.P. 74.94 and M.P. 77.71	2.77 mi.	2.50 mi.	\$116,817.07	\$88,278.00	\$97,070.00	\$1,738.00	\$115,139.07	\$63.00
Between M.P. 78.92 and M.P. 84.93	6.01 mi.	5.75 mi.	277,431.40	\$1,603,000.00	15,207.00	989.00	14,218.00	\$7,336.42
Between M.P. 89.38 and 290.93	1.55 mi.	1.50 mi.	197,797.47	\$1,000,000.00	10,000.00	900.00	9,100.00	\$1,281.35
Between M.P. 297.37 and M.P. 303.00	.63 mi.	.50 mi.	111,043.97	\$1,000,000.00	10,000.00	5,500.00	12,500.00	\$9,498.97
Between M.P. 313.40 and M.P. 330.84	1.44 mi.	1.47 mi.	139,269.66	\$1,000,000.00	81,000.00	10,700.00	13,300.00	\$3,079.66
Between M.P. 336.39 and M.P. 379.93	1.20 mi.	1.20 mi.	197,486.17	\$1,000,000.00	13,147.00	970.00	14,000.00	\$9,639.17
	21.60 mi.	21.62 mi.	\$1,908,600.00	\$1,000,000.00	\$1,784,000.00	\$28,000.00	\$1,812,000.00	\$18,740.00

By the Court:

Q. Have you a small map of that road, Mr. Loree, that will give me some idea of the general location?

Mr. UENTERMYER. I have one, Your Honor, which I will hand to you.

By Mr. UENTERMYER:

Q. There were approximately six portions in which this work was done in the main? A. There were six portions in which it was decided to do the work off the existing line of right of way. All the balance of the work was done on the line of the right of way.

Q. There was considerable done on the right of way? A. Yes, sir.

Mr. UENTERMYER. I want to call attention in the mortgage which is in evidence, to another provision among the conditions imposed upon the company under article fourth, "Covenants of the Railway Company," subdivision "(p)," as follows:

The railway company will not issue, negotiate, sell, or dispose of any of the refunding and improvement bonds in any manner other than in accordance with the provisions of this indenture, and in issuing, selling, negotiating, or otherwise disposing of the refunding and improvement bonds from time to time well and truly it will apply, or cause to be applied, the same or the proceeds thereof to and for the purposes herein prescribed and to and for no other or different purpose.

Then there is a provision enabling them to declare a default if we apply any of this money other than to actual capital improvements. This mortgage was acknowledged the 30th of June, 1909, although it took effect on July 1st and bore date as of July 1st.

The actual making of the order of the commission complained of, of which we say we had notice on August 16th, was the 1st of July. We do not understand it was promulgated then, but it was dated then.

By Mr. UNDERMYER:

Q. Mr. Lorce, what is the capital of the Kansas City Southern and what was its share capital in 1906? It has not been changed, has it? A. No, sir. \$21,000,000 preferred stock and \$30,000,000 common stock.

Q. Its bonded debt prior to the issue of the mortgage put in evidence here was how much? A. \$30,000,000.

Q. That was secured by mortgage? A. Yes.

Q. And the bonds bear interest at the rate of 3 per cent, do they not? A. Yes, sir.

Mr. UNDERMYER. I offer in evidence, Your Honor, the articles of association of the Kansas City Southern Railway Company, and call attention.

Mr. NEEDHAM (interrupting). I do not see that that is necessary. It is admitted and the capitalization is admitted as stated in the petition.

Mr. UNDERMYER. Let us see if the Government admits that.

Mr. DENISON. We have admitted it by not denying.

Mr. UNDERMYER. If the Government has admitted it there is no necessity for encumbering the record.

It is admitted, is it, that the allegations of the petition in that respect are admitted by the Government, as well as by the Interstate Commerce Commission? Is that correct?

Mr. DENISON. Yes.

Mr. NEEDHAM. Yes.

By Mr. UNDERMYER:

Q. This question that is now before the court very vitally affects the interests of the preferred stock, does it not? A. It does; yes, sir.

Q. If the order of the commission is enforced and this improvement is to be charged, as required by that order, to operating expenses the accounts would not show the earning of the dividends on the preferred stock, would they? A. They would not.

Mr. DENISON. I object to that; it calls for a conclusion.

Mr. UNDERMYER. If you object to the conclusion, your objection is well taken. I will change the form of the question.

Mr. DENISON. It depends entirely on the number of years over which the charge could be made in the operating expenses. If it were charged to three hundred years it would only be a thousand dollars a year.

Mr. UNDERMYER. We are here upon an order that does not even distribute the charge for that matter.

Mr. DENISON. But it is under a rule which provides it shall be distributed.

Mr. UNDERMYER. No; it is not. It is under a rule that gives the commission the discretion and authority, if it sees fit, to spread it over a term, but the commission not only did not do so, but, according to the allegations of our petition, undenied, and admitted in fact, refused to do so and refused to give us any relief whatever, and the position as it stands to-day is that these operating expenses have to be charged out of current.

Mr. DENISON (interrupting). There was no application made to the Interstate Commerce Commission, as I understand it, for the distribution of these charges over a series of years, and it has been denied.

It is denied, as I understand it, that there was such an application made or that the commission—

Mr. UNTERMYER (interrupting). If my friend will read the pleadings he will see the situation is about as follows, as shown by paragraph 8 of the petition:

Beginning in October, 1900, your petitioner has made repeated efforts to secure from the Interstate Commerce Commission a ruling whereby the commission would determine either that the above-mentioned orders are invalid, so far as they apply to the circumstances above set forth, or that the said circumstances presented an exceptional situation not embraced within the purview of said orders and classifications.

The Interstate Commerce Commission has refused and failed up to the present time to grant your petitioner any relief whatever in the premises, but on the contrary has notified your petitioner that it must comply with the above-mentioned requirements, and that it must charge to its operating expense and profit and loss accounts the estimated replacement value (less salvage) of the portions of your petitioner's lines abandoned as an incident to the making of grade reductions.

The answer admits the allegation contained in the eighth paragraph of said petition as true, "excepting as they are, or any one of them is, modified or controverted by facts, hereinafter set forth in this answer."

I say the issue made there is a demand under the terms of the order that this expenditure shall be charged against operating expenses of the road. The Interstate Commerce Commission has never undertaken to exercise any discretion with respect to subdividing them or scattering them over a period of years, and we say the commission has refused to give us any relief whatever from that order as made; and that is the way the situation stands now. Still, that is something to be argued hereafter. We have a right to show now what is the effect of this order and what the commission can do under it—that is the proposition—how preposterous the order is, because the legal effect of this order has to be determined, not by what the commission will do under it, but by what it can do under it. In other words, it can destroy property values. That is the reason we say it is absolutely beyond their power to make any such order, and that has been our contention from the beginning.

Mr. DENISON. You mean to ask this court to assume the Interstate Commerce Commission will act outrageously?

Mr. UNTERMYER. On the contrary, it is assuming nothing of the kind. It is to ask the court merely to determine the scope of the power by what is allowed and permitted to be done under the order.

Mr. NEEDHAM. I do not understand we are arguing this case now. I simply want to correct this statement, that under no construction of the pleadings that can possibly be made can the commission be said to have refused an application to distribute this account over a period of years. There is nothing in the petition that will justify any statement of that kind.

The COURT. Mr. Untermyer's question is now to enable the court the better to understand what would be the effect of this order by following out what he construes to be the mandate of the commission.

Mr. UNTERMYER. And, furthermore, to enable this court when we come to the final argument to determine whether or not an order of that kind is within the power of the commission—an order by which it takes unto itself the discretion of whether or not it will so destroy

security values under the guise of having been given power by Congress to determine the form of account.

The COURT. That would be a question of law arising upon the testimony.

Mr. DENISON. Your honor, I think the question is in form decidedly objectionable.

Mr. USTERMYER. So do I.

Mr. DENISON. I object to the form on rather deeper grounds than mere superficial ones. If my friend wishes to bring out that fact, I think what we should learn is this: Over what term of years would the thing have to be spread in order to avoid losses to the preferred stockholders?

The COURT. That you must get in time.

Mr. USTERMYER. If my friend will tell me how much we will earn in each year in the future, we will tell him.

Mr. DENISON. If he can not know that, he can not answer the question.

Mr. USTERMYER. We can show the fact of what he has done.

The COURT. Here is the view I take of that: Here is a gentleman called as an expert witness, qualified and well qualified by his previous experience, and, as laying the foundation for the matters of fact to be adduced from the testimony and from which conclusions must eventually follow, it seems to me entirely proper to propound just such questions, assuming the form to be somewhat changed. I think counsel has that right. It may be developed on cross-examination or it may be Mr. Ustermyer himself will propound questions which will ascertain exactly what the premise of the witness is when he answers the questions; but so far as it goes, he having changed the form, it seems to me it is proper.

Mr. DENISON. Do I understand this specific question is withdrawn?

Mr. USTERMYER. Yes; if you object to the form.

Mr. DENISON. If you claim article 8 of this petition alleges that application was made to the commission to distribute that charge over a period of years, I would like to have a ruling to that effect, because we do not admit any such claim as that and we have not made any such admission. I have not intended to make any such admission, and if that is the construction of that paragraph I would like to move to amend the answer.

Mr. USTERMYER. I do not contend, because it is not the fact, that we have ever made any application to the commission to spread this item over a series of years under the operating expenses. On the contrary, our constant and insistent contention has been that it had no business in operating expenses. On the other hand, the commission has made an order and the commission has not directed that this be spread over a series of years.

Mr. NEEDHAM. Our position is quite important on that matter.

Mr. USTERMYER. Whatever legal effect may follow from that, that is another proposition; but I am quite willing to admit we have made no application to spread this charge over a series of years under the head of operating expenses. On the contrary, we have consistently and insistently claimed, and are claiming here, it has no business in operating expenses.

Mr. NEEDHAM. That is, I understand the question to mean that if the total \$600,000 is charged in the one year to operating expenses, you will be unable to pay a dividend upon that preferred stock?

Mr. UNTERMYER. Yes; and it follows also in logical sequence that if it is spread over ten years, it might have the same effect, because we might earn less than \$60,000 short of our preference dividend in any one year. So the legal effect of it is somewhat different from the way you put it.

Mr. NEEDHAM. We have a right to know upon what basis this witness is giving his conclusion—whether he is giving it upon the assumption that this is wholly charged in one year or whether he is giving his opinion upon the assumption that it is spread over ten years—and that is my objection to the question.

The Court. You will simplify matters and perhaps cut off a great deal of argument if Mr. Untermeyer will propound the question he would like to have answered.

By Mr. UNTERMYER:

Q. If this entire expenditure were to be put into operating expenses for this year, would it or not have made it impossible to pay the four per cent dividend on preferred stock?—A. If this entire amount were charged to operating expenses in the fiscal year ending June 30, 1912, it would make it impossible to pay the dividend on the preferred stock.

Q. And those dividends are not cumulative?—A. No, sir; they are not.

Q. They are payable only out of the earnings of each current year, year by year?—A. That is right.

Q. Suppose they should be spread over a series of years? Of course, whether or not that would affect the ability to pay the dividends on preferred stock would depend on the extent of other earnings, would it not?—A. That is a little problematical.

Q. If, for instance, they were spread over ten years, making the charge to operating expenses \$63,000 a year, and you came \$63,000 short of that dividend, this would make it impossible to pay it?—A. It would.

Q. So it must necessarily be problematical what would be the effect of such a proposition on subsequent years?—A. And this would be cumulative as to other analogous improvements.

Q. The effect of it would be really to paralyze railroad improvements, would it not?—A. It would.

Q. And will you tell the court as an expert what is the effect of this order, in the doing of railroad improvements, upon their being done economically or otherwise?

Mr. NEEDHAM. As to what road?

Mr. UNTERMYER. As to any and all roads, and the vicious and pernicious effect of an order of this kind, in not only paralyzing improvements, but in wastefulness and in requiring improvements to be done in a way that will cost the most money.

Mr. DENISON. That is a question of morals.

Mr. UNTERMYER. No; it is not.

Mr. NEEDHAM. I object to that as applied to roads generally and as to what the effect of this order would be. It leads us into a very wide field. It seems to me it is improper to give a mere opinion as



to what the effect of such an order would be upon the railroads of the country as a whole.

Mr. USTERMYER. The order is promulgated as a whole.

The COURT. I think an expert can answer a general question of that kind.

By Mr. USTERMYER:

Q. Will you explain that, Mr. Lorce?—A. I think the practical effect of this order is to bring about a wasteful method of doing betterment work, and to hold back a good deal of betterment work that would otherwise be done.

Q. Will you explain in what respect it promotes a wasteful doing of the work?—A. Very often, instead of substituting a new improvement for an old one, the old one is continued in use to avoid the charge to operating expenses.

Q. For instance, old and abandoned tracks, if they are left down, you do not have to charge off, do you?—A. We do not.

Q. But if you take them up and use them and allow for them, then the whole thing goes against the operating expenses?—A. It does; yes, sir.

Q. That you think promotes a wasteful method of doing improvements?—A. It does.

Q. Did the company have current earnings that were available for this improvement, with the other improvements that they have already applied them to?—A. They did not.

Q. This was the only way of doing them—by raising of the money?—A. It was.

Q. Would it have been possible to have borrowed the money with which to have brought about these improvements on the more expensive method of doing the whole thing on the old line?

Mr. NEEDHAM. I object to that, because it was borrowed on that very plan.

Mr. USTERMYER. No; you are mistaken. It was borrowed to be done in this way.

Mr. NEEDHAM. The report, as I understand it—I have not read it all—was to make the improvement on the right of way as it existed, as it was presented to the stockholders. I think the petition fairly states that, and I understand that to be the fact; that the discovery of doing it by a cheaper method and abandoning part of the right of way came after the stockholders' meeting.

Mr. USTERMYER. No, Dr. Needham, you are mistaken. That is the method that was recommended by Mr. Burt of doing it in the way in which it was done.

Mr. NEEDHAM. That is not the fair inference from your petition.

By Mr. USTERMYER:

Q. Am I right about that, Mr. Lorce?—A. You are.

The COURT. I asked that very question.

By Mr. USTERMYER:

Q. It was always contemplated under Mr. Burt's report to do it in the way in which it was done?—A. That is right.

Q. And money was borrowed to do it in that way?—A. It was.

Q. To have done it in any other way would have required the borrowing of more money than the company could have borrowed?—A. I think so.

The COURT. The difference between \$1,230,000 and the sum that was actually expended in doing it in the way it was done, which approximates \$600,000.

Mr. UNTERMYER. We took more money because we have more of this work to do.

Mr. DENISON. Did I understand him to say you could not have borrowed the additional \$600,000?

Mr. UNTERMYER. It was not the additional \$600,000 alone, because this is only part of the work we are doing. This only includes 41 per cent of the line. You will notice in the requirements under the mortgage it was provided that \$1,200,000 should be expended for this purpose, of which only \$600,000 has been spent. We expect to do more work.

The COURT. Has it appeared what would have been the cost of the other method?

Mr. UNTERMYER. Yes, sir; just double.

The COURT. It is claimed you could not have borrowed \$1,250,000 to do it on the other plan?

Mr. UNTERMYER. We had other improvements under contemplation, too.

Mr. NEEDHAM. I want to understand what this answer is.

Mr. UNTERMYER. You can cross-examine.

Mr. NEEDHAM. I did not want to cross-examine now, but I did not just hear your views fully.

By Mr. UNTERMYER:

Q. Mr. Lorce, as I understand you, the plan of doing the improvements in the way in which they were done was the plan on which the money was borrowed and the bonds were sold?—A. That is right; yes, sir.

Q. I asked you whether or not it would have been possible to have sold bonds and raised money upon the more expensive method of doing these improvements.

Mr. NEEDHAM. I object to that, and call your honor's attention to the allegation of the petition, page 5, the third allegation of the petition, in which Mr. Burt's work is set forth, and which says:

From the reports and estimates made by Mr. Burt, acting in the capacity of consulting engineer, and by your petitioner's other engineers, your petitioner ascertained that the reduction of its grade to .5 of one per cent at said six portions of its line by the method of raising or lowering the then existing roadway, or both, on the then existing right of way, would have required the expenditure of approximately \$1,230,318.99.

And that is the sum they authorized.

Mr. UNTERMYER. Oh, no. Read the next paragraph. That will tell the story.

Mr. NEEDHAM. But the authorization was for \$1,230,000.

Mr. UNTERMYER. But that covered more than the work we have done. Part of that is reserved for further grade reduction.

Mr. NEEDHAM. But it says, Mr. Untermeyer, that it was for these six changes.

The WITNESS. The amounts simply happen to coincide. About half of the \$1,250,000 we raised was spent on the right of way

in grade reduction, but half of it was spent on these six portions of the line that required the removal of track off the right of way to the new location.

By the COURT:

Q. That is a mere coincidence?—A. Yes.

By Mr. NEEDHAM:

Q. Half of what sum?—A. \$1,250,000 for which bonds were sold.

By Mr. UNTERMYER:

Q. The total appropriations for changes of grade so far have been about \$2,750,000, have they not?—A. Yes, sir.

Q. \$2,750,000 have been appropriated for changes of grade?—A. Yes, sir.

Q. Out of this money raised from the sale of these \$10,000,000 of bonds?—A. We subsequently sold an additional \$5,000,000.

Q. You have sold \$15,000,000 now?—A. Yes, sir.

Q. Does this paper now in your hand show the appropriation of the proceeds of the bonds?—A. It does; yes, sir.

Q. Up to what time?—A. Up to the present time, except as to the application of \$5,100,000 for the cancellation of notes.

Q. But it shows the total appropriations for improvements?—A. It does; yes, sir.

Mr. UNTERMYER. I will offer that statement as exhibit No. 8, your honor. I want to read this to your honor at this time. [Reading:]

THE KANSAS CITY SOUTHERN RAILWAY COMPANY. FUNDS PROVIDED BY THE SALE OF BONDS AND APPROPRIATED FOR IMPROVEMENTS.

For reducing grades to .5 of 1 per cent on five full operating divisions, aggregating 66 per cent of the entire line:	
July, 1909	\$1,250,000.00
February, 1911	1,500,000.00
	2,750,000.00
For rearranging five division terminals, to permit of better and more economical operation under the 16-hour law and to provide more adequate facilities for taking care of power and traffic:	
July, 1909	1,000,000.00
February, 1911	250,000.00
	1,250,000.00
For ditching, ballasting, new rail, and improvements to track and bridges:	
July, 1909	1,000,000.00
February, 1911	2,062,500.00
	3,062,500.00
For improving terminals at Kansas City and Port Arthur; for facilities for securing new business and for other corporate purposes:	
July, 1909	1,275,000.00
For providing new equipment:	
February, 1911	1,000,000.00
	9,337,500.00
Grand total	

With the exception of \$446,008.16, the above funds have been specifically appropriated to the intended uses.

The sum of \$1,814,203.03 remains to be expended.

NEW YORK, March 2, 1912.

The COURT. We will suspend until 2 o'clock this afternoon.

Thereupon at 12.30 o'clock p. m., a recess was taken until 2 o'clock p. m.; at which time an adjournment was taken tentatively to Thursday, March 21, 1912, at 10.30 o'clock a. m.

WASHINGTON, D. C.,

*Monday, May 6, 1912—10.30 o'clock a. m.*

Present: Mr. Justice Carland.

Appearances: Mr. Samuel Untermeyer, for the petitioner. Mr. Winfred T. Denison, Assistant Attorney General, for the United States of America, respondent. Mr. Chas. W. Needham, for the Interstate Commerce Commission, intervening respondent.

PROCEEDINGS.

L. F. LOREE, heretofore duly sworn, resumed the witness stand as a witness on behalf of the petitioner and testified further as follows:

Direct examination (continued) by Mr. UNTERMEYER:

Q. Mr. Loree, on page 46 of your testimony you were asked the following question:

Q. And the estimated cost of doing it in the way it was done was how much?

This has reference to the cost of grade reductions in the way in which they were made and not upon the original right of way and outside of the right of way.

Your answer was:

\$629,399.74.

Q. And that is the way it turned out, is it not?—A. Yes, sir.

Q. I mean it was done for the estimated amount?—A. Yes, sir.

Do you desire to make a correction of that testimony?

A. That is, the actual cost of the work as done was \$791,000. The work overran the estimates.

Q. Have you investigated to ascertain whether or not the actual cost of doing the work upon the original right of way, which was estimated at \$1,200,000 and upwards, would have overrun the estimate in the same proportion?—A. I think so; yes, sir.

Q. Was not the actual cost of this work, in the way in which it was done, \$763,798.00?—A. Those are the right figures.

Mr. DENISON. Where should that be noted, Mr. Untermeyer?

Mr. UNTERMEYER. On page 46 of the record.

By Mr. UNTERMEYER:

Q. That work is now completed, is it?—A. Yes, sir.

Q. So you know the actual cost?—A. Yes, sir.

Q. Has your road men in the field soliciting business?—A. Yes, sir.

Q. In competition with other roads?—A. Yes, sir.

Q. About how many men have you in the field?—A. I do not remember the exact number. Our traffic expenses run about \$23,000 to \$25,000 a month.

Q. That is for soliciting business?—A. Soliciting and supervising the soliciting of business.

Q. There are about fifty men in the field, are there not?—A. I do remember the exact number. We have a large number of them.

Q. Had you substantially the same number of men in the field in 1909 and 1910?—A. Substantially. There have been one or two men created since then. In 1909 and 1910, you say?

Q. Yes.—A. Yes; we have substantially the same.

Q. What were the conditions in railroad business in that section with respect to your road and its competitors prior to the making of the improvements which are the subject matter of this controversy that rendered it necessary that the company should increase its capacity and provide for an enlarged public service?—A. The characteristic feature of the traffic of the Kansas City Southern is that it consists largely of a freight taking very low rates—lumber and coal and oil, and commodities of that character.

Q. Then it became necessary to reduce your operating cost to the minimum, did it?—A. Yes, sir.

Q. Do you remember how the freight revenue per mile on your road compares with that of your competitors?—A. It is substantially lower. I should think, except for the Missouri Pacific, the other roads would have better rates per ton-mile than we have.

Q. And the Missouri Pacific also would have a better average rate per ton per mile?—A. Yes, sir.

Q. Is that due to the low-class freight you carry?—A. Yes, sir.

Q. So, in order to compete it became necessary, did it, to make these grade reductions in the interests of economy of operation?—A. We thought so.

Q. Is there any doubt about their accomplishing that purpose?—A. We think not.

Q. What is the operating saving through these grade reductions?—A. We figure that the cost of freight-train movement would be decreased about one-half over the divisions where the changes were made.

Q. You stated on page eight of your testimony that the rates on the Kansas City Southern were about the same as on competing lines. Do you care to explain that?—A. I meant by that that the rates between the point of origin and point of destination had necessarily to be, in order to get the business at all.

Q. You mean the rate upon the given character of commodity?—A. Yes; we had to meet the other lines' rates.

Q. But the general class of commodities you carry have a lower average freight rate?—A. Yes, sir; they have.

Q. I think you have given us a table on that subject, have you not?—A. Yes, sir.

Q. What would be the effect upon the improvements of the Kansas City Southern of putting into operation the accounting methods as construed by the Interstate Commerce Commission in this case, and as required by them, so far as affects the questions here at issue?

Mr. NEEDHAM. I object to that question as to what the effect upon—I suppose you mean their traffic?

Mr. UNTERMYER. No; I mean upon postponement of improvements, the effect upon improvements, not upon the traffic.

Mr. NEEDHAM. I object to that. It seems to me that is rather foreign to the question of the proper accounting for improvements made. I suppose your honor understands the real issue in this case?

The COURT. I think I do; yes.

MR. NEEDHAM. It is the question of whether or not abandonment is depreciation, and if it is depreciation, how it shall be credited off in the accounts of the company; and the position of the Interstate Commerce Commission is that it is a part of the depreciation and therefore must go, if it is not reproduced in kind, to the profit and loss account; if it is reproduced in kind, then to the expense account; and what effect that will have upon their policy of improvements in the future, it seems to me, can have no direct bearing upon the correctness of the accounting.

MR. UNTERMYER. It is not a question of what effect the policy of improvements will have. It is a question of what effect the construction the commission gives to these regulations will have upon the making of improvements by railroads, as determining whether or not this is a reasonable provision, and whether it is a reasonable construction that they are putting on this regulation. I understand this class of questions was deemed competent and material by Judge Hunt when we went into this branch of the subject at the last session. The question is not precisely as stated by Dr. Needham, however. I think there is a very radical difference between the proposition as he states it and the proposition as we understand it.

The improvements here, as your honor may remember from the discussion we had some weeks ago, were made upon the old line of railroad. The grade reductions were not made on the old line of road, however. It would have cost twice as much to have made those grade reductions on the old line of road as to make them in the way we did make them, by abandoning these different parts of the old line. It would have cost us about \$1,500,000, it seems, to have made them upon the old line of road, and it has cost \$763,000 to make them in this way. It is admitted that if these grade reductions had been made upon the old line of road they would be a capital charge for the full amount, but because we made them at less cost and more efficiently it is claimed that we must charge off our capital account the old abandoned line at its present value.

THE COURT. Whether these entries which are to be made in pursuance of the order of the commission would affect the business of the company in any way, perhaps is a matter to be debated, but I think you have a right to offer testimony if you claim that it does affect it in any way, and the objection will therefore be overruled.

MR. UNTERMYER. Please read the question to the witness, Mr. Stenographer.

THE STENOGRAPHER (reading):

What would be the effect upon the improvements of the Kansas City Southern of putting into operation the accounting methods as construed by the Interstate Commerce Commission in this case and as required by them, so far as affects the questions here at issue?

THE WITNESS. I think we would not have undertaken this work if we had thought we would have to charge it out in the way the commission contends for, and other work that we might do we would not want to undertake.

By MR. UNTERMYER:

Q. If undertaken at all, would it or not have involved doing it in a more expensive method, by making the grade reductions on the old

line of road?—A. I think it would have if we wanted to protect our preferred dividends, because our preferred dividend would not stand such an expense and operating expenses.

Q. You could not have made these improvements and charged them to operating expenses and paid your preferred dividend at the same time?—A. We would not have thought so.

Q. Is it not a fact you could not have made them at all with the money which you borrowed for the purpose of making them?—A. That is true.

Q. Under the terms of the mortgage?—A. That is true.

Q. The effect of that would be simply to impede improvement looking to increased efficiency in railroad service?—A. It would; yes, sir.

Q. Do you remember when, in point of fact, the notice of the order of the Interstate Commerce Commission, of which complaint is made here, was served on the company?—A. I do not; no.

Q. In point of time it was served, was it not, after all the money had been borrowed and you had started on your improvements?—A. I understand it was served on the 16th day of August.

Q. 1909?—A. Yes, sir.

Q. Is it or not a fact that this classification, on which the present attitude of the Interstate Commerce Commission is based, was not ready for distribution on July 1, when this mortgage was made?—A. That is my understanding; yes, sir.

Q. And not for some time afterwards?—A. No, sir.

Q. Will you state, from your experience as a railroad man, whether or not the changes as made were made in the most economical way for the securing of lower grade and efficient service?—A. I think they were; yes, sir.

Q. And is it or not a fact, beyond question, that, if made in the other way, the cost would have been approximately double the present cost?—A. It would; yes, sir.

Q. And would not have allowed an increased efficiency?—A. In no way; no, sir.

Q. I call your attention to the following testimony, at page 49 of the minutes, in your previous examination:

Q. There were approximately six portions in which this work was done, in the main?—A. There were six portions, in which it was decided to do the work off the existing line of right of way. All the balance of the work was done on the line of the right of way.

Does that testimony refer only to the first installments of grade reductions?—A. It does; yes, sir.

Q. You did not mean, did you, that there was a second installment, which included both reductions on the original right of way and additional changes?—A. Not in that answer. There was a second installment, which included seven changes, being on the right of way, and the balance of the work was done on the right of way.

Q. Those are not included in the testimony here, although they will be involved in the determination of this case?—A. That is correct; yes, sir.

Q. Does the same rule that applied to the grade reductions that are the subject matter of this controversy also apply to those which have since been made with respect to the proportionate cost by the one method and by the other?—A. Approximately; yes, sir.

Q. Does the same testimony apply with respect to the comparative effectiveness of the change?—A. It does; yes, sir.

Q. Do you know what will be the difference in cost by one method and the other of these grade reductions?—A. I do not have it in mind. The work is not yet completed.

Q. But they are quite as considerable as those that have been made and which are the subject matter of this controversy?—A. Yes, sir.

Q. I call your attention to a statement in paragraph 9 of the answer of the Interstate Commerce Commission in this case, in which the commission refers to section 20 of the interstate commerce act, to the effect that the act requires common carriers to make reports showing the cost of the carrier's property, and to their claim that this means the true net cost of the road as actually operated at the time the return is made, it being a part of their contention that the portion abandoned must be written out, as it is no longer used, and the cost of the abandoned property no longer a part of the road actually operated at the time the return is made. In that connection, is any of that property really abandoned property which is not used when a grade reduction is made off the original line of the road?—A. In the sense we have gone away from the property, we have left it; but the line has not been interrupted. There is still a line between the original termini in operation.

Q. Your line still runs between the two points between which it did run?—A. Kansas City and Port Arthur; yes, sir.

Q. The points at which it is no longer operated, because the reduction of grade is off the line of the old road, are not worn-out parts of the property, are they?—A. They were not; no, sir.

Q. Were they in good physical condition?—A. They were.

Q. Had they been maintained up to the same point of efficiency as the rest of the line?—A. Fully.

Q. There was no element of their being destroyed or useless for operating purposes?—A. No, sir.

Q. Is it or not a fact that the sole purpose of making these grade reductions in the way in which they were made was to increase the efficiency of the road?—A. That is correct.

Q. By minimizing the cost of operation?—A. Yes, sir.

Q. And that purpose they accomplished?—A. They did.

Q. Is it or not true that to-day, between the points on which these grade reductions were made, you have a road more efficient, at least to the extent of your expenditures on the grade reductions?—A. We feel so; yes, sir.

Q. This road, I think you have told us, as originally constructed and as it existed before these grade reductions were made had an average grade of how much?—A. One per cent, except in the mountain district.

Q. And there it was how much greater?—A. It was 1.35.

Q. When the road was constructed I suppose it went through a sparsely populated district?—A. Very, and heavily timbered.

Q. There has been a great deal of lumbering done on the line of the road?—A. A great deal; yes, sir.

Q. Was the road as originally constructed sufficient for its then needs?—A. It was.

Q. Was it defectively constructed or well constructed, having regard to the country through which it then passed and the needs of



that country?—A. I think it was ample to serve the then needs of the country.

Q. Was it about the same grade of road as were other roads that were then constructed in that country?—A. I think so; yes, sir.

Q. The location of the road having a 1 per cent grade will not coincide except incidentally at certain points of location with a road with a five-tenths per cent grade will it?—A. It will not.

Q. It has to be surveyed on a different basis?—A. Yes, sir; you have to find entirely different supporting ground for the one grade than for the other.

Q. You mean for different supporting ground?—A. Yes, sir.

Q. Would a road as constructed with the average 1 per cent grade, except in the mountain districts where it is greater, have cost as much to construct as if it had originally been constructed on a five-tenths per cent grade?—A. It would not.

Q. And a road constructed on a five-tenths per cent grade has a greater intrinsic value, has it not?—A. It has; yes, sir.

Q. Approximately to the extent of the difference in the cost of construction?—A. Yes, sir.

Q. Is it then the fact that this road, reconstructed with this grade reduction of five-tenths per cent, has a relatively greater value than a road constructed on the 1 per cent grade?—A. It has; yes, sir.

Q. So that is an actual addition to the capital account, is it?—A. It is; yes, sir.

Mr. NEEDHAM. That I object to, if your honor please. It can not be necessarily—

Mr. UTERMAYER (interrupting). That is argumentative any way.

Mr. NEEDHAM. That is not real valuation. Valuation is the value net, and cost which goes to capital account is an entirely different thing. A man may build a property that cost \$100,000 which may become worth a great deal more.

Mr. UTERMAYER. That is not what we claim.

Mr. NEEDHAM. I object to the last question as to the increased capital account.

Mr. UTERMAYER. I will withdraw the question. Perhaps it is a conclusion, and I will withdraw it.

The COURT. Very well.

By Mr. UTERMAYER:

Q. Taking into account the circumstances of this particular case, Mr. Loree, will you say whether or not this road as originally constructed, in the country through which it then went, and constructed on an average 1 per cent grade, was or was not merely a stage in the progress of the construction of a road that would eventually, when the country grew up, have to have a five-tenths per cent grade?—A. I think so; yes, sir. That is the history of nearly all the roads in the United States. They all had to be changed in their character.

Q. As their needs increased and their traffic increased?—A. Yes, sir.

Q. And in a new, sparsely settled territory, such as this was when the road was constructed, could it have supported a line built as expensively as a five-tenths per cent grade would require to be built?—

A. I think not, and I do not think the money could have been raised to do it.

Q. You could not have gotten the capital for it?—A. No.

Q. It is the invariable history of railroad construction, is it not, that the lines have to be improved as business increases?—A. That has been the history of the country; yes, sir.

Q. When you are building a line through a new country, you can not get the money to build it as it eventually must be built when the country is built up?—A. That is true.

Q. What should you say, then, as to the original road in respect to its being in the nature of a temporary structure?—A. I should say it had that element in it; yes, sir.

Q. And that is an element incident to all railroad construction?—A. I think so; yes, sir.

Q. As an expert, having qualified in the way you explained to us, will you tell us whether or not, in your judgment, this reduction of grade was therefore in its nature and essence an improvement to the original property?—A. I think it was; yes, sir.

Q. A capital improvement?—A. I think so. It was made on the theory that the road would maintain its then existing earnings and that the traffic would earn something more than the interest charges on the additional money invested.

Q. And in your judgment there is no doubt as to that result?—A. There is not; no, sir.

Q. You mean an increased net earning, do you not?—A. Yes, sir.

Q. And it also increases the capacity of the road, does it not?—A. It does; yes, sir.

Q. Increases its capacity for gross traffic?—A. Yes, sir.

Q. Let me ask again, because perhaps I have not made it quite clear, as to whether prior to the making of these improvements there had been any deterioration?—A. (Interrupting.) No, sir; there had not.

Q. (Continuing.) Upon the basis of the roads that were abandoned?—A. No.

Q. None whatever?—A. No.

Q. The idea of loss in that respect is precluded from the question?—A. We think so; yes, sir.

Q. Is it your opinion that the line of railroad, considered as a unit, has been enhanced to a sum equal to at least the cost of these improvements?—A. Yes, sir.

Q. But for that you would not have made these improvements?

A. That is correct.

Mr. UTERMYER. That is all.

Cross-examination by Mr. DENISON:

Q. I understood you to say this reduction of grade was essential to the continued successful operation of your road in the future?—A. We thought so.

Q. And in fact, it has worked a reduction of the operating expenses by fifty per cent over the lines affected?—A. We feel we have increased our train loading about that per cent; yes, sir. It has about doubled our train load, and we think we have decreased the movement expense about fifty per cent.

Q. And yet you say if you had known in advance this method of accounting would be required, you would not have made that improvement at all?—A. I do not think so; no, sir.

Q. You would have abandoned your whole road?—A. No; we would have abandoned the idea of making these changes.

Q. But you say these changes were essential to the life and prosperity of the road?—A. I think so; yes, sir.

Q. And yet you would not have made them if you had to make them with this method of accounting?—A. I would not have recommended them.

Q. In other words, you would have let the road die then?—A. No; we would have kept it where it was.

Q. But you have testified the road could not live and prosper without those changes.—A. And take care of the increased business. We would not have been able to go on and take care of the increased business. Business in that community normally grows between ten and fifteen per cent a year.

Q. Did you not testify distinctly it was essential to the life of the road in the future that those changes should be made?—A. Yes; and that was the idea, with the idea of growing—

Q. (Interrupting.) How could the road continue to live without the changes which were essential to its life?—A. It could continue to exist in its then state.

Q. Then you also stated that if you had done it, knowing these rules about the accounting, you would have chosen a way which would have cost the company the most?—A. We would have had to do it; that would have had to be done; yes, sir.

Q. In other words, you would have saddled the stockholders, preferred and common, with an additional unnecessary capital charge?—A. Yes, sir—that is, I think the credit of the railroad depends upon the maintenance of its preferred dividends. I do not think its stockholders—

Q. (Interrupting.) It all comes down to maintaining the preferred dividend?—A. I think so. I do not think that money could have been borrowed unless we had established ability to pay the preferred dividends.

Q. And you would have preferred, as a director of that company, to have thrown away six hundred thousand dollars uselessly rather than to have seemed to impair the preferred-stock dividends at all?—A. Yes, sir.

Q. And that additional increased capitalization, of course, would have been one of bonds, would it not?—A. Yes, sir.

Q. And those bonds you were proposing to issue at five per cent?—A. Yes, sir.

Q. At ninety-six and a quarter?—A. That is what we got for them; yes, sir.

Q. In other words, on the bond issue of \$1,200,000, which would have been what was approximately essential for this work, you would have created an annual interest charge of at least sixty thousand dollars, would you not?—A. Yes, sir.

Q. And that would have been ahead of the preferred-stock dividends, would it not?—A. Yes, sir.

Q. And that would have been all that would have gone in ahead of the preferred-stock dividends?—A. That would have gone in ahead; yes, sir.

Q. On the other basis there would have been an ultimate charge of \$600,000?—A. Yes, sir.

Q. If that had been distributed over a period of ten years, it would have come to only sixty thousand dollars a year, would it not?—A. I do not follow your figures.

Q. If you got six hundred thousand dollars to charge to operating expenses over a term of ten years, at an equal amount each year of the ten years, you would have to charge sixty thousand dollars a year, would you not?—A. That is correct; yes, sir.

Q. In other words, on the existing plan, if the commission had required a distribution of that charge of six hundred thousand dollars to operating expenses over a period of ten years, it would have required a charge of sixty thousand dollars a year?—A. Yes, sir.

Q. Which would be precisely the same as the interest charge on the \$1,200,000 at five per cent, would it not?—A. Yes, sir.

Q. If that is so, if such a charge had been made, and the term had been so distributed by the commission, what advantage would there be to the company in saddling the company with a capital charge of \$1,200,000, instead of having the charge on the basis of sixty thousand dollars a year to operating expenses, without the excessive interest?—A. We would not have gotten the work at all under those circumstances.

Mr. USTERMYER. Could not have gotten the money?

By Mr. DENISON:

Q. Why?—A. Because we could not have afforded it.

Q. You could not have afforded to save six hundred thousand dollars without any extra annual cost?—A. We could not have afforded to undertake the work at that price.

Q. You could have afforded to undertake the work at a cost of \$1,200,000, of which \$600,000 would be unnecessary?—A. No, sir. I think you are confusing the amounts. The gross amount that we borrowed was \$1,250,000, of which about one-half was expended on the right of way and about one-half expended for these six portions off the right of way, and we would not have borrowed \$1,800,000 to do the work.

Q. I would like to confine your question to the particular point that is in controversy—that is, the portions that were off the right of way. Those portions, you say, if you had realized this method of accounting, you would have preferred to have done at a cost of \$1,200,000 rather than at a cost of \$600,000?—A. Yes; but I would not have undertaken it at all at a cost of \$1,200,000.

Q. I want to know why not. Is it not true, as you testified, that you could have undertaken it at a cost of \$600,000, and if the commission had allowed you to distribute that over a period of ten years, your annual charge would have only been \$60,000?—A. Our annual charge now is \$60,000 on the money that we have put into the grade reductions, and I would not have made it at \$90,000. I would not have done the work at all if I had had to do it in that way.

Q. You say your annual charge is now \$60,000?—A. Yes, sir.

Q. Not with reference to the six pieces we are discussing?—A. No; with reference to the money we borrowed.

Q. I am talking about these six pieces in controversy here particularly?—A. I would not have increased the charge of thirty thousand dollars to sixty thousand dollars. I would not have undertaken the work—

Q. (Interrupting.) If the commission so distributed the charge on operating expenses as to make the amount charged each year no greater than the amount of the saving in cost of operation, the preferred stock dividends could not have been affected, could they?—

A. Not by that item; no, sir.

Mr. DENISON. That is all.

By Mr. NEEDHAM:

Q. Mr. Lorce, the contract for the work on these six portions of the line was signed August 25, 1909?—A. I understand so.

Q. As stated in your petitions?—A. Yes, sir.

Q. That is correct, is it not?—A. Yes, sir.

Q. When were the contracts made for the improvement of the even sections to which you have referred in your direct examination this morning?—A. I think in 1911, in the spring of 1911.

Q. Can you give the month?—A. I think probably in April.

Q. April, 1911?—A. Yes.

Q. It is stated in the petition that the cost of making the improvements on these six sections or at the points of these six sections, if made on the original line would have been \$1,230,318.99. Is that correct?—A. Those are Burt's figures.

By Mr. USTERMYER:

Q. Is that correct?

By Mr. NEEDHAM:

Q. Is it substantially correct?—A. In view of our experience in doing the work on the six portions, I think that would have been substantially increased, because Mr. Burt's estimate was about \$630,000 on this basis and the actual cost was \$736,000.

Q. The estimate of the expense was \$1,230,318.99?—A. Yes, sir.

Q. And that covered simply the six portions?—A. That is right.

Q. The six portions of the road which have been made under the contract of August 25, 1909?—A. That is correct.

Q. When did you discover that by changing the line and abandoning certain portions, you could reduce the grade by an expenditure of approximately \$629,399.74, that being the estimate at that time?—A. At the time Mr. Burt submitted his report in 1907.

Q. Was that included in the report which gave the estimate of the cost for improving the line on the right of way?—A. It was, and his recommendation was that we improve it by going off the right of way.

Q. Was that submitted to the stockholders at their meeting?—A. It was submitted to the board of directors. I do not know as to the stockholders.

Q. Was there any proposition before the board of directors or the stockholders at any time which involved the improvement on the right of way only at an expense of \$1,230,000?—A. The executive committee all went personally through Mr. Burt's report. My

recommendation was on the basis of that report, that the work be done off the right of way.

Q. You never treated that as a separate proposition from the other; that is, you treated them together and chose between them?—

A. Yes, sir.

Q. The net saving, using now the estimated figures as stated on page six of your petition, was \$600,949.25 by making the improvements in the way they have been made?—A. Yes, sir.

Q. What was the reason for making the estimate as it was made?—

A. It is the ordinary method of doing that work.

Q. Showing what it would cost upon the right of way and what it would cost to make it by abandonment of parts of the line?—

A. Yes, sir.

Q. That is the usual method of making estimates, is it?—A. Where it is possible to make the two methods. Sometimes it can only be done by a new location.

Q. Why then did you include in the estimate of reducing the grades the sum of \$1,250,000, as stated on page 3 of your petition?—

A. Because I wanted to reduce the grades on three full operating divisions, and the additional amount was required for such work as was to be done on the right of way. There were quite a number of places where we could do the work on the right of way.

Q. Did that include seven sections to which you have referred?—

A. No; it did not. Those were on two operating divisions separated from these by three or four hundred miles.

Q. What sections of the road were included in that in addition to the six sections upon which the improvement was made?—A. This work includes the division between Stillwell and Heavener, in Oklahoma and Arkansas—it lies all in Oklahoma, I think; the division between De Queen and Shreveport, in Arkansas and Louisiana; and the division between Leesville and Port Arthur, in Louisiana and Texas. The other improvements include the division between Kansas City and Pittsburg, in Missouri and Kansas, and between Pittsburg and Neosho, in Kansas and Arkansas.

Mr. UNTERMYER. This \$1,250,000 involves work done on the right of way as well as that done off the right of way in those sections.

Mr. NEEDHAM. I understand.

By Mr. NEEDHAM:

Q. Which of these divisions, which you have just described in your last answer, covers the six sections upon which the work has been done?—A. The first three.

Q. What sections in your description are included in the seven sections under the contract of 1911?—A. The latter two.

Q. And that covers all that was contemplated when this issue of bonds was made, in which there is an estimate of \$1,200,000 for such improvements?—A. There were two issues of bonds. The \$1,200,000 for these improvements is only to be used on the first three sections. We made a subsequent issue and appropriated for the work that was to be done on the additional two sections.

Q. Then this \$1,250,000 was the issue to take care of the six sections?—A. The six diversions from the line; yes, sir; the work on the right of way in those three operating divisions.

Q. And that covers, as I understand your answer, the six sections covered by the contract of August 25, 1909?—A. Yes, sir.

By Mr. USTERMYER:

Q. And the work on the right of way?—A. And the work on the right of way in addition.

Mr. NEEDHAM. But on that section of the road?

Mr. USTERMYER. Yes.

By Mr. NEEDHAM:

Q. Not on other sections of the road?—A. No; just section south of Ozark Mountains.

Mr. USTERMYER. The question here at issue is only as to the work done off the right of way. There was \$1,250,000 of work done, of which \$639,000 was off the right of way within those sections. There is no question as to work done on the right of way, because the commission does not claim that should be charged to operating expenses.

The WITNESS. Perhaps if we rehearse it, we will get it.

Mr. NEEDHAM. I think I understand it. All I want to know in my last question is this, that \$1,250,000 was to provide for the improvements which were covered by that contract of August 25, 1909?

Mr. USTERMYER. Is that your question?

By Mr. NEEDHAM:

Q. Is that correct, Mr. Loree?—A. That is right; yes, sir.

Q. Part of that, you say, was for improvements made on the right of way and part of it made on the sections that were abandoned?

A. No; the company undertook to do it itself, with its own forces, all the work on the right of way, and contracted the work off the right of way; and the six sections were done under contract.

By Mr. USTERMYER:

Q. That was the \$639,000?—A. Yes; that was the \$639,000.

By Mr. NEEDHAM:

Q. The balance of it was expended by the company?—A. The balance of it was expended by the company.

Q. In the intervening points, between the sections that were improved off the right of way?—A. They were scattered along at different points; yes, sir.

Q. It was not covered by that contract of August 25, 1909?—A. No, sir.

Q. Were those improvements made upon that section of the road?—A. Yes, sir.

Q. Entirely?—A. They were all made on those three operating divisions; yes, sir.

Q. Those which you have described?—A. Yes, sir.

Q. You have spoken of your freight on that road as low-class freight, consisting of lumber, coal, and oil?—A. And grain; yes, sir.

Q. Where does that originate on your line?—A. The lumber originates largely in Louisiana, goes to Port Arthur for export, and goes north for distribution mostly to our connections. The oil originates partly on our line at Caddo, and we get it through connections from the Oklahoma fields. The grain originates largely in Kansas, and we get it from Kansas City, which is the second primary market in the country.

Q. Where is that carried?—A. That is carried to Port Arthur for export, and carried to Louisiana and Texas for local consumption. It goes off our rails there to our connections.

By Mr. UNTERMYER:

Q. That is, the grain?—A. Yes. There are three coal fields between the Mississippi River and the Rocky Mountains—one in Iowa, which we do not touch; one in Missouri and Kansas, which we run through; and one in Oklahoma and Arkansas, which we run through. The Arkansas coal takes local distribution and goes to connections, and the Kansas coal goes mostly north to connections at Kansas City.

By Mr. NEEDHAM:

Q. What is the average haul on lumber for export to Port Arthur?—A. I should think the average haul was about one hundred and twenty-five miles.

Q. Does that move in full trainloads?—A. I should say it was picked up or made up with other commodities. We do not separate it at all.

Q. Does it move in full carloads?—A. That is, as a rule, loaded at the mills.

Q. What about the oil?—A. The oil moves in tank cars.

Q. First, let me ask, What is the average haul on lumber going north?—A. About six hundred and fifty miles.

Q. How does it move—in carloads?—A. In carloads; yes, sir.

Q. And is made up within what radius?—A. I should think that field covers about one hundred and fifty miles.

Q. The rest of the haul, then, is a through haul?—A. Yes, sir.

Q. What about the oil?—A. The oil is loaded in tank cars, either on the line at Caddo or in the Caddo field, and there we get a haul of about three hundred and twenty-five miles.

Q. Which way?—A. South. It goes to the refineries at Port Arthur. We were getting until recently—and I think the shutdown is temporary—a large amount of oil from the Oklahoma field, which comes to us at Panama.

Q. How does that move?—A. That goes south to the refineries at Port Arthur.

Q. Does that move in tank cars?—A. Yes, sir.

Q. All oil moves in tank cars?—A. Practically, except a little barrel distribution.

Q. How much of that goes north?—A. Just now there is quite a little movement going up into the Chicago district.

Q. What is the haul there?—A. I should say it was three hundred and seventy-five miles.

Q. Where does the grain originate which you haul?—A. We get that at Kansas City largely. It is brought in there by all the lines serving Kansas and that territory.

Q. What is the haul south on that?—A. That is 786 miles, the full length of the line.

Q. That moves in carloads for export?—A. Yes, sir.

Q. And is taken from Kansas City?—A. Yes, sir; except that which is distributed through Louisiana and Texas, and that is distributed largely through Texarkana and Shreveport and Lake Charles, and I should think the average haul on that was probably six hundred miles.

Q. That moves in carloads and is distributed to your connections?—A. Yes, sir.

Q. By switch?—A. Yes, sir.



Q. Has there been in any case any increase in the volume of this traffic since you made these improvements on the six sections?—A. This year has been a pretty bad year, but generally there is an increase.

Q. You said that ordinarily there would be an increase from growth and development of the business of about ten per cent?—A. Per annum; yes, sir.

Q. Has there been anything representing any addition to that because of the improvements you have made on your road?—A. I do not think I could say that now, because this year the traffic has fallen off. We are behind in our earnings about six hundred thousand dollars.

Q. That is owing to what cause?—A. They had a long strike, lasting four or five months, in the lumber districts, and after that was over the heavy rains prevented their getting the logs out of the forest.

Q. It is not attributable to the fact that business has been taken from your line by competing lines?—A. Not at all; no, sir.

Q. As compared with former years, are you getting any greater proportion of business from competing lines than you got before you made these improvements?—A. Our business this year, except as to lumber and oil, is about holding its own with last year. The general business of the territory, I think, is a little off as against last year.

Q. And yet you attribute the fact that you were holding your own to the improvements which you have made on your road?—A. I should think not, because we have been very much congested with the work we have been doing. It is not all finished yet. There is some under way on the north section.

Q. You have reached the benefits you expected to realize?—A. No, sir; except on some divisions.

Q. In making these improvements did your company expect to increase its gross earnings and traffic beyond the increase in the country generally?—A. We thought so; yes, sir.

Q. That is, by taking traffic from your competitors?—A. We thought we would be able to furnish superior service and get more than the share we would otherwise enjoy.

Q. In what would that superior service to the shipper be represented?—A. Better movement.

Q. Quicker movement?—A. Quicker and more uniform.

Q. That is a greater regularity in the delivery?—A. Yes, sir.

Q. And a faster service?—A. Yes, sir.

Q. Would that be an improvement over what your competitors were furnishing at that time?—A. We thought so.

Q. And is at the present time?—A. Yes, sir.

Q. From your experience since you made these improvements, have you changed your opinion with reference to that?—A. No, sir.

Q. You still expect these improvements will increase the volume of traffic over your road for the reasons you have stated?—A. Yes, sir; I do.

Q. Have you made any difference in the rates on these general commodities?—A. No; there have been no changes. There was an advance about three years ago in some of the rates, but they were all through that territory and not by us alone—on a few commodities.

Q. Is it not true that this low-grade traffic which you speak of, when it moves in car lots and long distances and with regularity in volume, is the most profitable business any railroad has?—A. I think so; yes, sir.

Q. The roads that are carrying this low-grade freight—coal, lumber, grain, and oil—where it moves with regularity and over long distances in car lots, are the most prosperous roads we have to day, are they not?—A. I should add to that that they are well equipped with heavy power and have cut their grades down to get cheap operating cost.

Q. I will accept your amendment. That is true, is it not?—A. Yes, sir.

Q. Were these contracts, which were made in August, 1909, in pursuance of public bids?—A. Yes, sir.

Q. When did you call for the public bids?—A. I do not remember the date, but I know there were a number of bids taken and inquiry was made.

Q. (Interrupting.) Approximately how long before the contract was let were those called for?—A. A month or six weeks, I should say.

Q. When were bids accepted with reference to the time the contract was made?—A. Within a day or two. Inquiry was made at my office from Kansas City as to the reputation and financial standing of the Ferguson Construction Company, to whom the bids were let, and I made inquiries through the banks and through some railroads for whom they had done work, and that probably delayed the matter four or five days.

MR. NEEDHAM. I think I am correct in my recollection. I will not be sure—that the witness said the reduction of cost was about fifty per cent in movement.

MR. USTERMYER. I do not think that would mean reduction in total cost, but in train movement.

THE WITNESS. Just the movement—wages and fuel and oil.

By MR. NEEDHAM:

Q. You have stated that there was a reduction in cost of train movement of about fifty per cent on account of these grade reductions?—A. Per ton per mile; yes, sir.

Q. Explain just what you mean by that.—A. I mean by that that the train movement expense consists of the actual expense of moving the train as we figure it—the wages and supplies and things of that kind—and that we doubled up the loading behind the engine and cut the cost per ton-mile in two.

Q. Just state, if you will, what the change has been since these improvements have been completed in the size of your trains.—A. I do not have the tonnage figures, but they are about double.

Q. That would apply to all the heavy freight to which you have referred?—A. Yes, sir.

Q. What increase have you made in your motive power to carry the additional load?—A. We have recently purchased some larger engines and they have only been delivered within the last month and they are not to be used on these sections where the grade reductions were made.

Q. They are to be used on the sections where the grade has not been changed?—A. Yes, sir.

Q. Then you are hauling, on the sections where the grade has been changed, with the same motive power and are hauling double the load? A. Yes, sir.

Q. Are you a member of the Association of Railway Accountants? A. I am not; no, sir.

Q. Is your company represented there? A. Yes, sir.

Q. Were you not a member of that association at one time, Mr. Green? A. Never; no, sir.

Q. Who represented your company in that association? A. Mr. Williams, one of our vice presidents. Oh, on the Kansas City Southern, Mr. McCarty was the representative there.

Q. How long did he represent you in that association?—A. I do not recollect as to that.

Q. You know about that association, do you? A. Yes, sir.

Q. You know its objects? A. Yes, sir.

Q. The men representing the different railroads upon that association are the expert accountants and statisticians of the roads?—

A. They are usually the men in charge of the accounting of the road; yes, sir.

Q. They are not executive officers? A. No, sir.

Q. They are supposed to be expert upon those questions? A. I fancy so; yes, sir.

Q. That is what you employ them for, I suppose? A. Yes, sir.

Q. When were you first employed by or connected with the Kansas City Southern? A. May, 1906, I think it was—May or June, 1906.

Q. What time in 1906 did you say?—A. I think in May or June.

Q. You were aware at that time, in 1906 and subsequent thereto, that the matter of a uniform system of bookkeeping for railroads was under consideration by that association, were you not? A. If I knew it, I knew it in a general way. I had no detailed knowledge of it.

Q. Did you have any knowledge that they were considering that subject? A. I do not now recollect. I had been out of the business for some 18 months before that and not in touch with it, and I do not now recollect.

Q. After 1906 and in 1907, after you had been a year with the Kansas City Southern, did you know then that the association was considering the matter of railway accounts and a uniform system?—

A. My first distinct recollection about it is that some time in May, I think, 1907, there was brought to my notice a form of accounts which the commission proposed to put into effect, and I took it up with the commission and asked them if they would not give the executives a hearing before they adopted it.

Q. When was that?—A. I think that was in May, 1907.

Q. From whom did you receive that?—A. I have in mind the vice president of the Delaware & Hudson Company, and, I think, I got it either from the accounting officer of that company or from the Interstate Commerce Commission direct; I am not sure which.

Q. Did you not receive at that time or very soon after that, and during that summer, a statement of a proposed or tentative statement from the committee of the Railway Association of Accountants?—A. I have no recollection of receiving anything from the Railway Committee of Accountants.

Q. Do you know that there was appointed a committee of twenty-five by the railway association to consider the proposed uniform system of accounting?—A. I understood so; yes, sir.

Q. Do you know when that committee was appointed?—A. No, sir.

Q. Do you know that they held a meeting in Buffalo, in 1907, in July?—A. I understood so; yes, sir.

Q. Were you advised of the action taken there?—A. Yes, sir.

Q. When did you receive advice of that action?—A. I think immediately after the adjournment of the committee I received verbal advice as to what it was.

Q. You understood that that committee was acting in conference with the Interstate Commerce Commission?—A. I understood Mr. Adams was present at their meeting.

Q. Mr. Henry C. Adams represented the Interstate Commerce Commission?—A. Yes, sir.

Q. He was an accountant with the Interstate Commerce Commission?—A. Yes, sir.

Q. You understood that he met with the committee?—A. Yes, sir.

Q. At the Buffalo meeting was there a tentative statement of a system of uniform accounts put out for consideration by the executives of the railroad?—A. I think there were one or more matters there that were the subject of sharp division between them, and finally submitted to the executives for decision.

Q. As an executive did you receive a copy of that?—A. I discussed the matter with the Delaware & Hudson representative. I do not remember whether I saw a printed copy or not.

Q. But you did have the statement?—A. I had the statement from him and discussed it with him; yes, sir.

Q. You discussed with him the attitude to be taken regarding some of these provisions?—A. Yes, sir; I might say I sustained him in his position.

Q. Was the matter of the charging out of abandoned property one of the items you discussed?—A. It was; yes, sir.

Q. That was one of the items in the tentative report of the committee adopted at Buffalo?—A. Yes, sir.

Q. There was another meeting of that committee at Atlantic City following the Buffalo meeting, was there not?—A. Yes, sir.

Q. Do you remember the date of that?—A. I do not; no, sir.

Q. Were you present?—A. No, sir.

Q. Did you, as an executive of the Kansas City Southern or the Delaware & Hudson, give any instructions to your representative or representatives on that committee as to the position you thought should be taken?—A. I sustained the position he proposed to take there; yes, sir.

Q. To whom do you refer?—A. Mr. W. H. Williams, vice president of the Delaware & Hudson Company, in charge of accounts.

Q. Who represented the Kansas City Southern at that time?—A. I do not think they were a member of that committee.

Q. You do not think they had a member on that committee at that time?—A. No, sir.

Q. In talking with Mr. Williams about it, did you talk with him both as a representative of the Delaware & Hudson and of the Kansas

ity Southern?—A. I think only as representing the Delaware & Hudson.

Q. You did not give him any views regarding your position as an executive of the Kansas City Southern?—A. It is not my recollection that I discussed it at all; no, sir.

Q. Did you, in giving him your views about it, confine yourself entirely to your position with the Delaware & Hudson?—A. That and the general proposition itself.

Q. Then you did take the position as an executive with reference to it as a general proposition applicable to all railroads?—A. Yes, sir; that is, he submitted it as a proposition of accounting and I sustained the position which he took.

Q. Let me understand that. Your position, then, was with reference to that question as it would affect all railroads or as it would affect the Delaware & Hudson?—A. Both.

Q. There was considerable interest in the Atlantic City meeting, was there not, Mr. Loree?—A. I judge so; yes, sir.

Q. And a good deal of discussion of the proposed accounts between the executives of the different railroads?—A. I do not know as to that.

Q. You do not know about that?—A. No, sir.

Q. You had no discussion regarding it with other executives of the railroads?—A. My recollection is there was some correspondence at the time. I think I heard from two or three of them, but I am not positive about that.

Q. You know as a matter of fact that a tentative plan adopted at Buffalo was sent to all of the executives of the principal railroads, do you not?—A. I do not know as to that; no, sir.

Q. I asked whether you knew. Was it your understanding?—A. I assume that it was. I do not know as a matter of fact anything about it.

Q. You knew the matter was to come up again at the Atlantic City meeting?—A. I did; yes, sir.

Mr. NEEDHAM. I think that is all.

By Mr. DENISON:

Q. Mr. Loree, has an estimate been made of the net earnings for the current fiscal year?—A. Yes, sir.

Q. What is it?—A. I think we will go out of the fiscal year with approximately \$875,000 net applicable to dividends.

Q. And the dividends take how much?—A. \$840,000.

By Mr. UNTERMYER:

Q. That is, the preferred dividend requires \$840,000?—A. Yes, sir.

Q. That is, without charging off matters that are claimed should be charged off by the commission?—A. Yes, sir.

By Mr. DENISON:

Q. Let me see if I understand that. You say the estimated net corporate income applicable to the dividend is \$840,000?—A. Yes. I think we will make about \$900,000 net.

Q. That is about one-half of what it was for the last four years?—A. Yes, sir.

Q. And that loss is due to this information which you have testified to in answer to Mr. Needham?—A. It is due to loss of gross revenue in lumber and oil, and due to high operating cost on account of very bad weather.

Mr. DENISON. That is all.

Redirect examination by Mr. UNTERMYER:

Q. You say \$900,000, the estimated earnings for this year, will be about one-half the earnings of the preceding year. It is a good deal more than that, however, is it not?

Mr. DENISON. He said \$840,000.

The WITNESS. \$840,000 is required for dividend on the preferred stock. I think our net earnings applicable to dividends will be about nine hundred thousand dollars.

By Mr. UNTERMYER:

Q. Your earnings in previous years have not been twice that, have they?—A. No, sir. They were about \$1,400,000 last year, as I recollect it.

By Mr. DENISON:

Q. For the fiscal year ending June 30th, 1911, they were \$1,666,000, were they not?

Mr. UNTERMYER. I do not think you have taken off everything there.

Mr. DENISON. That is the net income applicable to preferred stock. However, this year, you say, it is \$900,000?

The WITNESS. Yes.

Mr. DENISON. And \$840,000 of that is taken for preferred dividends?

The WITNESS. Yes.

By Mr. UNTERMYER:

Q. When you say that \$900,000 will be your estimated net earnings for the current year, have you allowed anything whatever by way of charge to operating expenses for any of those grade reductions with respect to which the commission is making claims here in controversy?—A. No, sir.

Q. And those charges to grade reductions, as thus far made, where the grade reduction was made off the line of the original road, amount to something like \$1,200,000 or \$1,500,000, do they not?—A. Yes, sir.

Q. And those expenditures are—

Mr. NEEDHAM (interrupting). That includes the seven sections?

Mr. UNTERMYER. Yes; of course.

By Mr. UNTERMYER:

Q. And that expenditure for grade reductions off the line of road is in addition to the expenditures which you have made for grade reductions on the line of road?—A. It is; yes, sir.

Q. And those amount to approximately how much?—A. About as much more.

Q. So that in rough figures, under this plan that was adopted in conformity with the recommendation of Mr. Burt's report, the road has spent and is spending approximately \$2,500,000 in grade reductions, has it not?—A. Nearer \$3,000,000.

Q. You were asked by Mr. Denison on cross-examination with respect to this Burt report, as to whether or not the executive committee of the road exercised the choice of methods of grade reduction pointed out by that report, one being that all the grade reductions should be made on the line of the road and the other being that some of the grade reductions should be made off the line of the road. There was such an alternative plan presented by Mr. Burt, was there not?—A. They went through the Burt report, and I recommended that they adopt the recommendations of Mr. Burt and do this work off the line of road.

Q. And that was at a cost of one-half what it would have been on the line of road?—A. Yes, sir.

Q. There were some grade reductions, however, that could be advantageously made on the line of road?—A. There were; yes, sir.

Q. When you made that recommendation and your executive committee adopted it, to the effect that these grade reductions should be made off the line of road, was there any such regulation of the Interstate Commerce Commission as that of which you now make complaint?

Mr. NEEDHAM. There is no claim about that.

By Mr. UTERMYER:

Q. Was there any such regulation?—A. No.

Q. Was there any regulation in force or contemplated, so far as you knew, whereby, if you made the reduction off the line of the road, you would have to charge it out of your operating expenses?—A. I did not so understand it.

Q. If there had been, you could not have done it, could you?—A. No, sir.

Q. The effect of being required to make charges out of operating expenses for these grade reductions and to have been unable to pay your preferred dividend would have been what upon the credit of the road?

Mr. DENISON. We object to that, if your honor please. There is no foundation for the assumption that the distinction would have been made on the basis that would not permit the payment of the preferred dividend.

Mr. UTERMYER. It could not have been made on any other basis.

Mr. DENISON. \$39,000 a year would have allowed for that.

Mr. UTERMYER. I will show that your arithmetic is all wrong before I get through. It seems to me we are entirely at sea on the entire situation as you present it.

The COURT. If he knows he may state. The objection is overruled.

Mr. UTERMYER. It is part of the allegation of our petition and one of the complaints we make.

The WITNESS. We embarked on a general improvement of the road which involved raising \$1,500,000 by the sale of bonds. We would not have undertaken it at all if we had not thought we could have gone forward on the basis proposed.

By Mr. UTERMYER:

Q. As a capital improvement?—A. Yes, sir.

Q. You were only allowed to use the money for capital improvements?—A. That is the provision of the bonds; yes, sir.

Q. If these were simply operating expenses, this was a diversion of money that the bondholders gave, was it not?—A. Certainly that use was not contemplated.

Q. You knew you could not borrow money on a bond or mortgage to pay operating expenses?—A. Yes, sir.

Q. You have been asked on cross-examination whether a reduction of these grades was essential to the existence of the road and to its life. You did not mean by that that if these reductions in grade were not made you would have to go immediately into bankruptcy?—A. No, sir.

Q. But it would affect your power to compete, as you understood, and your growth?—A. Yes, sir.

Q. Is that what you meant by saying they were essential to your life and essential to the growth of the road?—A. Yes, sir.

Q. You were also asked whether it was possible that, if you had known such a regulation as this complained of would be made, you would have spent \$1,200,000 in order to get an improvement that you could have gotten by the method you pursued for \$600,000. I wish you would tell us whether or not, if you had known of these regulations, you could have made the grade reductions at all in the way you made them?—A. I would not have recommended them; no, sir.

Mr. NEEDHAM. He has been all over that.

Mr. UNTERMYER. And he has been cross-examined on that, and I am going to clear it up.

Mr. NEEDHAM. He went through it on direct examination.

By Mr. UNTERMYER:

Q. In the first place you could not have gotten the money, could you?—A. I think not.

Mr. NEEDHAM. We are going over the same ground we have already been over, your honor.

Mr. UNTERMYER. I do not think so. I am trying to reexamine the witness on redirect examination upon Mr. Denison's line of cross-examination.

The COURT. The objection is overruled.

By Mr. UNTERMYER:

Q. This \$600,000 here in question is only a part of the sum involved, is it not?—A. That is all.

Mr. NEEDHAM. That must be true, for that is the third time he has been asked that by you.

Mr. UNTERMYER. It is all made necessary by the peculiar examination of Mr. Denison. I am going to attempt to straighten it out, if I am permitted to do so.

By Mr. UNTERMYER:

Q. You were also asked by him whether you preferred to throw away \$600,000 rather than have a charge made to operating expenses extending over a period of years. What have you to say as to that?—A. My answer is that we would not have undertaken the work under those circumstances.

Q. You could not have undertaken it, could you?—A. No, sir.

Q. You could not have gotten the money?—A. No; I think not.

Q. Let me ask a question on the subject of Mr. Denison's arithmetic. He said if this item of \$600,000 was a charge against the



operating expenses, why would it not have been cheaper for you to have done it and had it scattered over and distributed over a period of ten years by the commission, making a charge of sixty thousand dollars a year, rather than to have paid \$1,200,000 to-day to do it as a charge against capital that would have carried with it an expense and interest charge of five per cent. or \$60,000. In the first place, it is a fact, is it not, that you had to have the money to start with before you could do it at all?—A. Yes, sir.

Q. And if you could not get the money on the basis of charging it as an operating expense, there would be no question of scattering it over a period of years, would there?—A. No, sir.

Q. In addition to that, you would have to pay the interest on the money, besides having a certain amount of this charged over operating expenses, would you not?—A. Yes, sir.

Q. So that \$60,000 a year, on the basis of distributing the charge, would not have been the only charge against you, would it?—A. It would not.

Q. You would have the interest charge on your capital investment besides?—A. Yes, sir.

Q. In an extensive improvement of this kind, some years are required for its completion?—A. That is correct.

Q. And during those years whilst the work is under way, the traffic is necessarily affected, is it not?—A. Yes, sir.

Q. So you do not expect to get the benefit of these improvements for some years after they are begun?—A. No, sir; not until they are finally completed.

Q. Referring now to the question as to whether the increased earnings would take care of this distribution of operating expenses, if it were to be regarded as operating expenses, it would not be expected they would begin to take care of it during the years of construction, would it?—A. No, sir.

Q. All this money required for these improvements was borrowed in June, 1909, was it not?—A. For these particular improvements; yes, sir.

Q. The contracts made, the obligations incurred, the money borrowed and the purposes to which it was to be applied were all settled in June, 1909?—A. Yes, sir.

Q. And you were asked by Dr. Needham what you knew as to a meeting in Buffalo and the action of the executives in Buffalo?—A. It was a committee of twenty-five of the Accounting Association.

Q. You stated that Mr. Williams had consulted with you and you had sustained his point of view?—A. Yes.

Q. Will you state what it was?—A. His view was that these were properly chargeable to capital account.

Q. That they were capital expenses?—A. Yes, sir.

Q. Did you and he consistently take that view from the beginning?—A. Yes, sir.

Q. And you have always contended for that, have you not?—A. Yes, sir.

Q. Was there any time when you agreed with the Railway Association or any representative of yours agreed that they should regard them otherwise?—A. No, sir.

Q. So far as you know, did the Railway Association ever take any position different from the one you have stated? A. No, sir.

Q. It has always so regarded it, has it? A. So I have understood, so far as definite action was concerned.

Q. And always contended against this method of accounting? A. Yes, sir.

Mr. USTERMYER. That is all.

Mr. NEEDHAM. Unless that is confined to his understanding, I object to it.

Mr. USTERMYER. Yes; so far as he understands.

The WITNESS. Yes.

Recross examination by Mr. NEEDHAM:

Q. The tentative report adopted at Buffalo and which you discussed with Mr. Williams.

Mr. USTERMYER (interrupting). We will have all those.

Mr. NEEDHAM. This is to get at his knowledge; that is all.

By Mr. NEEDHAM:

Q. This tentative report adopted at Buffalo and which you discussed with Mr. Williams provided for the charge of abandoned property of this character to operating expenses, did it not? A. My understanding was that the committee divided almost evenly on that subject.

Q. Never mind how the committee voted. I am not asking that. What did that tentative report show which you discussed?

Mr. USTERMYER. I object, on the ground that the report will undoubtedly be here and will show for itself. We are wasting a great amount of time discussing what this document showed when we can have the document itself.

Mr. NEEDHAM. We will have the document all right, but the witness has already testified to the discussion with Mr. Williams and that he approved Mr. Williams's position that it should be charged to capital account. Clearly, it is a proper question to ask him what the proposition was which they were discussing and why he thought it should not be charged to operating expenses. That is what brought up the discussion.

Mr. USTERMYER. I do not object to his being asked what was the proposition.

The WITNESS. Yes; that is correct.

By Mr. NEEDHAM:

Q. That was the proposition, was it? A. As to the form in which it was submitted; yes.

Q. And the discussion which you had with Mr. Williams and with other executives, if you had any discussion with other executives, was as to whether abandonment of this character should be charged to operating expenses or to capital account?—A. Or to profit and loss; yes, sir.

Q. And your position was it should be charged to capital account?—A. Yes, sir. I thought I would broaden that. I thought it ought to be left to the option of the railroad executives as to whether it should be charged to capital account; that is, capitalized or charged to profit and loss. I think it is entirely improper to charge it to operating expenses.

Q. But I understood you to testify, in answer to direct examination, that your position was that it should be charged to capital account. Is that right? A. Yes, sir; if we had to elect a single account, I think to capital account; but I think it ought to be optional whether it should be charged to capital account or profit and loss.

By Mr. UNDERMYER:

Q. And not to operating expenses? A. Not to operating expenses.

By Mr. NEEDHAM:

Q. Was that, as you understood it at the time, the position taken by the executives of the railroads? A. I do not know as to that, there was no general conference on the subject or anything of that kind. It was casual, whatever was had in the way of conference.

Q. The Atlantic City meeting, after the conferences with the executives, reversed the position taken in the tentative report?—

Their final report was the exact opposite to their tentative report.

Q. That was taken after discussion with the executives? A. And further discussion among themselves.

Q. You have stated the exact sum which you expended in making the improvements on these six sections. Will you state it again?—

The auditor's figures, as I recollect them, were \$763,798.

Q. That was the total expenditure, was it, on those six sections?—

Yes, sir.

Q. Under the rule of the Interstate Commerce Commission that whole sum is not chargeable to operating expense, is it? A. I so understand it.

Q. Is that your understanding of the rule? A. Yes, sir.

Q. Did you have anything to do with the making of Exhibit B to our petition? A. This is the net after deducting the amount transferred from the old line, and so on. This figure I understand to be the exact amount charged to operating expenses.

By Mr. DENISON:

Q. Which figure? A. The \$763,798.

By Mr. NEEDHAM:

Q. Does not the \$763,798 represent the estimated \$629,000? A. It does; but neither of those figures include the material transferred from the old line—the rail, etc.

Q. Are you quite sure about that? A. Yes, sir.

Q. Have you seen Exhibit B to your petition? A. I have read the petition over, but I do not recollect the exhibit.

Q. You signed it, did you not? A. Yes, sir.

Q. Exhibit B to your petition, on page 43, shows that out of the \$234,183, the amount charged to operating expense account under the rule of the commission, is \$386,181. Is that correct? A. I would have to refresh my memory by the figures.

Q. Would you like to see it? A. Yes.

The witness examined the exhibit in question.

Mr. UNDERMYER. It is simply deducting the cost of the abandoned line.

The WITNESS. This shows the cash expended was \$634,000.

By Mr. NEEDHAM:

Q. We have assumed, for the moment, that is a correct statement of the expense, for this question simply?—A. Yes, sir.

Q. Out of that, how much would be charged to operating expenses as shown by your account?—A. \$482,953.

By Mr. UNTERMYER:

Q. That is, less the material from the old line?—A. \$386,484.

By Mr. NEEDHAM:

Q. If they cost more than that—I mean if they cost \$739,000 the whole amount would not be charged to operating expense?—A. It would not alter that figure in any way.

By Mr. UNTERMYER:

Q. It would if the total cost—A. (Interrupting.) No; the estimate of the abandoned line would not change.

Q. But the charge against operating expenses would be larger, would it not?

Mr. NEEDHAM. Not at all; not at all.

Mr. UNTERMYER. Yes.

Mr. NEEDHAM. No. No matter how much it cost to make the new line—

The WITNESS (interrupting). It would not change the estimate of the old.

Mr. UNTERMYER. But the cost of the new line would change, and so would be an amount that would be chargeable against operating expenses.

The WITNESS. I do not so understand it.

By Mr. NEEDHAM:

Q. After making the expenditure of \$700,000, to which you have testified, the amount of that which would be chargeable to operating expenses would be \$386,484?—A. That is right; yes, sir.

Q. How much are you expending on the seven sections, which, you say, with the six and the improvement of the main line, amount to an expenditure of \$3,000,000?—A. I do not know what those figures are. The chief engineer has those.

Q. Do you know how much the valuation of the abandoned line in that improvement will be?—A. No. He has those figures. I do not have those.

Q. You have not those figures?—A. No, sir.

Q. Who is your engineer?—A. Mr. Johnston. He is here.

Q. He will testify to that?—A. Yes.

Q. Coming back to your knowledge, you did know in 1907 that the matter of providing a uniform system of accounts was before the Interstate Commerce Commission for determination, and that they were conferring with this committee of 25 of the railway accountants, which had been appointed for the express purpose of considering this matter?—A. Yes, sir.

Q. And you knew that at the Buffalo meeting they had taken the position that the value of the abandoned line, less salvage, should be charged to operating expenses, and you had opposed that?—A. Yes, sir. I did not regard that as at all—

Q. (Interrupting.) I did not ask how you regarded it. I want your knowledge. That is what I am after.

Mr. USTERMYER. I think the court should let him finish his answer.

The WITNESS. I know they were very sharply divided on the subject.

By Mr. NEEDHAM:

Q. That action of the committee of twenty five was reversed at the meeting at Atlantic City in June, 1908, the following year?—A. Yes, sir.

Q. You also knew that those recommendations were before the Interstate Commerce Commission, and that at least they had not decided which view they would take with reference to the abandoned properties?—A. In 1907?

Q. In 1908?—A. Yes, sir.

Q. And you knew at the time you took action in 1909 that the matter was pending before the Interstate Commerce Commission on these two propositions with reference to abandoned property, and so far as you knew at the time the stockholders' meeting was held it had not been determined by the Interstate Commerce Commission which plan they would adopt?—A. Yes, sir.

Q. You did know that it was a vital question that the commission was considering for the purpose of having a uniform system of accounts by railways?—A. I think it was vital; yes, sir.

Q. And you knew it was a pending question at that time?—A. Yes, sir.

Mr. NEEDHAM. That is all.

By Mr. USTERMYER:

Q. Did you understand the meeting at Buffalo had decided anything at all?—A. No, sir; not in any final way.

Q. It was not a decision at all?—A. It was not a decision. It was a statement of a recommendation.

Q. And that was by an equal vote, was it not?

Mr. NEEDHAM. I object to that. He was not there. The record will show just what was done. This examination has been for the purpose of simply showing his knowledge of the fact that that proposition was pending and that a tentative statement had been sent out. I have qualified that in all of my questions.

Mr. USTERMYER. It is not fair for the witness for counsel to ask a variety of questions, all of which call for hearsay, and then put the witness's testimony in the light in which he wants it to appear. I agree it is all hearsay.

The COURT. Then we will stop right there. The objection is sustained.

By Mr. USTERMYER:

Q. You have just been asked whether you understood that these recommendations that were then under consideration when you borrowed this money were a part of a uniform system of accounts. Did you ever understand them to be legitimately a part of any accounts?

Mr. NEEDHAM. That is not exactly what I stated.

Mr. USTERMYER. Practically it is.

Mr. NEEDHAM. Oh, no. I asked if he understood that there was pending before the Interstate Commerce Commission a proposition for a uniform system of accounts, which included this item, and he said he did.

Mr. UNTERMYER. That was not the question. I do not think counsel should object to our endeavoring to get the witness's statement clear upon the record. If you will turn back and read the next to the last question put to the witness as to a uniform system of accounts, Mr. Stenographer, perhaps Dr. Needham will admit he is mistaken.

The STENOGRAPHER (reading):

Q. You knew at the time you took action in 1900 the matter was pending before the Interstate Commerce Commission on these two propositions with reference to abandoned property, and so far as you knew at the time the stockholders' meeting was held it had not been determined by the Interstate Commerce Commission which plan they would adopt?—A. Yes, sir.

Q. You did know that it was a vital question that the commission was considering for the purpose of having a uniform system of accounts by railways?—A. I think it was vital; yes, sir.

Q. And you knew at that time that it was a pending question?—A. Yes, sir.

Mr. UNTERMYER. But I am cross examining.

The STENOGRAPHER (reading):

You have just been asked whether you understood that these recommendations that were then under consideration when you borrowed this money were a part of a uniform system of accounts. Did you ever understand them to be legitimately a part of any accounts?

The WITNESS. I think it goes far beyond that. I think it was an attempt to dispose of the capital of the company.

By Mr. UNTERMYER:

Q. You understood it was an effort on the part of the commission to dispose of the capital of the company?—A. Yes, sir.

Q. And not a system of accounting at all?—A. No, sir.

By Mr. NEEDHAM:

Q. By your last answer do you mean to qualify your statement that you knew that was under consideration?—A. I think that the accounts of the commission constituted an effort to control the operating—

Q. (interrupting). I did not ask that question.

Mr. UNTERMYER. I do not think the witness should be interrupted in the middle of his answer. I think the record should show his answer, and if it is not responsive it may be stricken out.

Mr. NEEDHAM. But I am cross-examining.

Mr. UNTERMYER. Dr. Needham is undertaking to stop the witness from completing his answer. Let him finish his answer, and then, if it is not responsive, I suppose it may be stricken out; but I do not think it is quite regular to chop him off from completing his answer, to chop him off every time in the middle of his answer. Will your honor permit the stenographer to read the question and the answer thus far given?

The STENOGRAPHER (reading):

Q. By your last answer do you mean to qualify your statement that you knew that was under consideration?—A. I think that the accounts of the commission constitute an effort to control the operating—

The COURT. Let him answer.

The WITNESS. I think that the accounts of the commission constitute an effort to control the operating expense and disposition of the capital funds of the railroad company.

Mr. NEEDHAM. I now move to strike out that answer as not at all responsive to the question. I asked whether he intended to modify his previous answer.

Mr. USTERMYER. That calls for any kind of an answer.

Mr. NEEDHAM. No; it does not. He has undertaken on direct examination to state that he does not regard the treatment of that question of abandoned property as a proper subject for the Interstate Commerce Commission to determine by a system of accounts. I think I quote him correctly with reference to that. I ask if he intends by that answer to modify what he has already stated—that he discussed the question and knew that it was a vital question under consideration.

Mr. USTERMYER. When you have gone over his whole testimony, as modified by something he is going to say, I suppose he is entitled to put himself right. It is a broad question and calls for almost any kind of an answer.

Mr. NEEDHAM. As to whether or not the Interstate Commerce Commission has power to determine whether the abandoned property shall be charged off in one way or another is one thing. Whether he knew that they were discussing or considering two recommendations, one of which provided that it should be charged to capital or profit and loss, and the other that it should be charged to operating expenses, is a very different question.

Mr. USTERMYER. Why not put another question?

The COURT. Put another question that can be answered by yes or no.

Mr. USTERMYER. He can hardly answer that in that way.

The COURT. Let him try it. Ask your question.

Mr. NEEDHAM. Read my question to the witness, Mr. Stenographer. The STENOGRAPHER (reading):

Q. By your last answer do you mean to qualify your statement that you knew that that was under consideration?

The WITNESS. No.

Mr. NEEDHAM. That is all.

Mr. USTERMYER. That is all with this witness, your honor.

Witness excused.

The COURT. We will take a recess at this time until two o'clock.

Thereupon, at 12.30 o'clock p. m., a recess was taken until 2 o'clock p. m. on this day, Monday, May 6, 1912.

#### AFTER RECESS.

WASHINGTON, D. C., *Monday, May 6, 1912—2 o'clock p. m.*

FRANK NAY was thereupon called as a witness on behalf of the petitioner and, being first duly sworn, testified as follows:

Direct examination by Mr. USTERMYER:

Q. State your full name?—A. Frank Nay.

Q. Where do you live, Mr. Nay?—A. Chicago, Illinois.

Q. What is your profession?—A. I am comptroller of the Chicago, Rock Island & Pacific Railroad Company.

Q. You are an accountant, are you not?—A. Yes, sir.

Q. Are you a member of an association of accountants?—A. Yes, sir.

Q. What association is that?—A. The Association of American Railway Accounting Officers.

Q. How long have you been connected with accounting for railways?—A. Twenty nine years.

Q. How long have you been with the Chicago, Rock Island & Pacific?—A. Nine years.

Q. What was your experience as an accountant prior to that?—A. During the four years just prior to that I was auditor of the Minneapolis & St. Louis Railroad Company, and during the fifteen years just prior to that, in various positions with the St. Louis Southwestern Railway Company, starting as statistical clerk and concluding my employment with that company as chief clerk to the general auditor; prior to that, one year with the Missouri Pacific Railway as statistical clerk.

Q. Then you are very familiar with railway accounts, are you not?—A. Yes, sir.

Q. Are you familiar with the various regulations and classifications that have been from time to time issued by order of the Interstate Commerce Commission?—A. Yes, sir.

Q. Are you familiar with the classifications and orders with respect to abandoned properties, those classifications and orders here in question?—A. Yes, sir.

Q. You know the questions that are involved in this case, do you not?—A. I think I do; yes, sir.

Q. Please state whether in your opinion the value of abandoned parts of the Kansas City Southern road that were abandoned, if you please, in connection with the grade reductions, are properly chargeable against operating expenses in any part?—A. My judgment is that they are not charges to operating expenses.

Q. Will you be good enough to state fully your reasons for that opinion?—A. My reasons are that the cost of such improvements—and I refer to where a line is built across a slightly different part of the country, perhaps a mile or two away from the old line and in place of the old line—that the cost of such construction of the new line is an additional investment of capital, and as such should always be represented in the capital account; that a railroad is never completed. In the first place, surveys are made three or four or five or six and sometime a dozen in number, and but one of them is adopted. The others might be said to be abandoned, but they were necessary steps in the progress of locating the line. The line is built for the conditions of traffic at the time of construction. Later it is necessary to improve it in various ways, and it may be built with one or one and a half per cent grade in the beginning. As the traffic grows it is necessary to reduce that grade for economy and efficiency in service. The reduction may be by cutting down high places in the road and filling in low places on the same right of way, or it may be by locating a line over a short distance from the old line. In either event, the ultimate purpose and result is the same, and the expenditures in either event represent additional investments



capital, and should remain in the capital account as showing the investment made by the company. That, briefly, is the statement of reasons.

Q. You know the fact with respect to this particular case, do you not, that these grade reductions were made in six instances off the line of road, and in other instances, where they better served the purpose, they were made on the line of road?—A. Yes, sir; I so understand.

Q. In your opinion, those grade reductions made off the line of the road should be charged to the capital account without any deduction whatsoever for the parts that were abandoned?—A. Yes, sir; with the exception of the salvage from the old line.

Q. Where it was used?—A. Yes, sir. Rails, which are usually about the only salvage you get, are what I have reference to. The ties remain there. But any salvage that is actually obtained should be credited to capital account, so that the net result will be the net increase in the investment.

Q. You know, do you not, that where the improvement is made on the line of the road, under the regulations it becomes a part of the capital account?—A. Yes, sir.

Q. Do you know any reason for that distinction in accounting?—A. No, sir. In a sense, the road underneath is abandoned as well as the road at one side is abandoned. I think the word "abandoned" is unfortunate. It is really revision and improvement.

Q. You would really call it a case of progress, would you not?—A. Yes, sir.

Q. Cost of progress?—A. Yes, sir.

Q. Capital cost of progress?—A. Yes, sir; that is the progress I had in mind when I said a railroad is never completed.

Q. Where the old line is left down and no part of it used for salvage, then under the regulations there is no deduction?

MR. NEEDHAM. Provided it is used.

MR. USTERMYER. Let us see about that. No; it is not provided it is used.

By MR. USTERMYER:

Q. Where the old parts of the road are not involved, you understand, do you not, that under the regulations there is no deduction?—A. That is my understanding. I have heard, I might say frankly, that it would be necessary to run a train occasionally over the line to maintain it; but that is technical, I think.

Q. Do you not know also that where these parts of the old line that are no longer used are left down and the formality complied with by the occasional train running over them, and they are afterwards abandoned two or three years later, then the regulations permit the charging of those abandoned parts of the line to the profit and loss account?—A. Yes, sir; I so understand, because such abandonment could then be said to be not in connection with the new construction.

Q. Those are manifest inconsistencies, are they not?—A. I think so.

MR. USTERMYER. That is all.

Cross-examination by MR. NEEDHAM:

Q. In the instance to which you have last referred, where the road is abandoned or the old line was used for a time, much or little, and

then was abandoned, it would be a case of abandonment without replacement in kind, would it not?—A. Yes, sir; I so stated in my answer to the direct question.

Q. What is the rule in reference to a bridge that is abandoned and a different type of bridge put in its place?—A. Do you refer to renewal of an existing bridge?

Q. That is what I say exactly—only as a bridge of a different type is put into its place, a higher type to carry heavier traffic, we will say?—A. There, again, I think the word “abandoned” is unfortunate. In the case you cite, it is where a bridge needs to be renewed. It has lived its life, and if it were renewed in kind it would be a proper charge to maintenance; and if renewed by a superior structure, then it is proper to charge operating expenses with the cost to renew that bridge in kind as necessary to maintain the property.

By Mr. UTERMYER:

Q. Where it is worn out?—A. Yes, sir.

By Mr. NEEDHAM:

Q. Let us assume this case: We have here a perfectly sound bridge upon a railroad that is increasing the weight of its equipment—cars and engines—requiring additional strength in roadbeds, and a new bridge is put in the place of an existing bridge that is in good condition; to what account, then, should the cost of building the new bridge be charged?

Mr. UTERMYER. Do you mean in his opinion or under the regulations?

Mr. NEEDHAM. I mean in his opinion; I am asking for his opinion. The WITNESS. Regardless of the regulations?

By Mr. NEEDHAM:

Q. Entirely so.—A. Let me understand that. The existing bridge, I understand, is supposed to be sound and good for several years yet?

Q. Yes; for the same traffic that it has been carrying, but not sufficient, of course, for the traffic proposed with the new equipment.—A. Of course, in my experience that is a somewhat impractical or unusual condition; but in such case I would charge the entire cost of the new structure to the capital account.

Q. What would you do with the cost of the old bridge?—A. I would do nothing with it.

By Mr. UTERMYER:

Q. You would leave it in the capital account?—A. I would leave it in the capital account.

By Mr. NEEDHAM:

Q. You would still leave that in the capital account?—A. Yes, sir.

Q. That is to say, if the old bridge cost \$100,000, and because of increase in the weight of equipment it was necessary to put in a stronger bridge, carrying a heavier weight, costing \$500,000, you would leave the \$100,000 in the capital account and add \$500,000 to the capital account for the new bridge?—A. Yes, sir; I would like to explain that that is an unusual condition. We have had occasions come up where the condition would confront us just as you have stated, but they do not put in a new \$500,000 bridge to renew a

0,000 bridge that is good for many years. We have put on extra and strengthened the bridge and charged the entire cost of strengthening to capital account. If the bridge is renewed by more expensive structure a practical railroad man will not do it unless the old one is pretty well worn.

Q. If it were strengthened in the manner you have suggested, by improvement of the old bridge, you think then the total cost of changes should be charged to capital account?—A. Yes, sir.

Q. But if the bridge is worn so as to require a new bridge, without reference to increase in equipment, but with reference to the use, what would you do then with the cost of the old bridge?—

I would charge that to operating expenses—repairs of bridges.

Q. Where it is worn and replaced in kind you would charge the cost of the new structure to capital account?—A. No, sir; where

bridge is worn and is needed to be renewed, if it is renewed in kind, the entire cost of the new structure would be chargeable to operating expenses as renewal in kind.

Q. On what theory?—A. On the theory that the operating expenses must furnish the maintenance for the existing property.

Q. Suppose that the bridge is not entirely worn out—so as to be safe, I mean—but has been in use a long time and a change is made to secure a higher type—for instance, from a wooden bridge to a steel bridge, how would you adjust the accounts in that case?—

Of course that, in my experience, is still a little bit unusual, because they renew a wooden bridge when it is well worn, and it is possible for a man to say exactly how long a wooden bridge will last; but usually they are renewed when they need to be. If there should be such a case where a bridge was half worn out I would say, as a matter of theory of correct accounting, that one-half of the cost of that old bridge should be charged to operating expenses on the same theory that operating expenses should furnish the maintenance of the existing property; but where the bridge is entirely worn, in the judgment of the engineers, and might possibly be good for two or three years longer, as I say, that is a nicety. They try to get it within the safe period. When it is replaced at that time, then it is perfectly proper to charge the cost to renew in kind to operating expenses.

Q. If a bridge is renewed in its vital parts as they become weakened the structure could be prolonged indefinitely, could it not?—A. I do not know that I quite understand.

Q. So far as the structure is concerned, you could keep it up for an indefinite length of time if you renewed at different times the parts that were worn and weakened by use?—A. You refer, perhaps, to a steel structure now?

Q. I refer to any structure.—A. Of course, as to a pile bridge, if the piling should become rotten before the ties and other timbers, the piles might be replaced and the other timbers might be replaced. Is that what you mean?

Q. Yes; and you can prolong the life of a bridge with its maximum endurance for almost any length of time, can you not?—A. I think that is true.

Q. Do you mean to say that changes have not been made in railroad building and operation in the last 10 or 20 years simply for the purpose of replacing the old existing structures which were com-

paratively good for the purposes for which they were built by new and better types?—A. No, sir; I did not mean to say that. I said this would be an unusual case. The ordinary case is not that.

Q. Is it not a fact that many of the existing roads in the East have practically rebuilt, and rebuilt with reference to the use of heavier equipment and heavier traffic in the last 10 or 15 years?—A. Of course, my experience has been largely with western roads, and the testimony which I give relates to the roads say west of Ohio. I have some general knowledge of conditions in the East. It is possible there has been some improvement of that kind which you suggest in your question. But in my own section of the country the usual case is to renew a structure when it is pretty well worn.

Q. Renew it by a new structure, or renew it by repairs? Which do you mean?—A. That depends. We are speaking of bridges. A pile bridge is usually renewed with a new pile bridge up to the time they decide to substitute for it a permanent structure, as we call it—a steel or concrete structure.

Q. That time comes to the steel bridge, if that type is adopted, and is put in in place of the old one?—A. Yes, sir.

Q. And is put in when the old one is or could be made by repairs as good as new?—A. I would not say is as good as new.

Q. So far as carrying the traffic is concerned?—A. Of course it carries the traffic until the day it is renewed.

Q. What I want to get at—there is no secret about it—is that the fact is that railroads are rebuilt upon new types of structures and have been during the last twenty or twenty-five years. I will say, and that all roads even in the West are gradually coming to that point where they have to change the type of the road by making the road-bed, including the bridges and structures, heavier and more expensive.—A. Yes, sir; and I think you hit the nail on the head when you put in the word "gradually." It has not been a thing done in a day or a year. By doing it gradually, they do not put in a steel bridge to take the place of a new pile bridge that was erected last year, but they will put in a steel bridge in the place of that pile bridge that was erected seven or eight years ago, so that the time has about arrived when the pile bridge must be renewed either in kind or by substitution of something different.

Q. In a case where they do substitute a new type of structure for the old, instead of repairing the old, then in your opinion the cost of the old should be retained in the capital account and the cost of the new added to the cost of the capital account?—A. Where the old one was a new bridge? Is that your question?

Q. No. My question is this: In a case where they do substitute a new type of structure for the old, instead of repairing the old, then, in your opinion the cost of the old should be retained in the capital account and the cost of the new added to the capital account?—A. No, sir.

Q. What is your opinion regarding the distribution of an account in cases which you have yourself referred to as being a gradual change of the type of the road?—As I have stated, my experience in handling accounts of railroads has been that the substitution of a steel bridge or concrete arch for an existing pile bridge is made at a time when that pile bridge needs to be renewed, either in kind or by this substitution referred to; and it is proper at that time to charge operating

expenses with the cost of the pile bridge. I might say that there is inconsistency there in the orders of the Interstate Commerce Commission, because of the requirement to charge operating expenses with the cost to renew in kind, as, for example, a pile bridge that was erected in the construction of the road thirty years ago costing \$20,000. It has been renewed from time to time. Prices of labor and material have increased, the renewals have been charged to operating expenses during all the years, and now it is time to renew it again. Under the increased prices of wages and material the bridge now costs \$4,000 to renew in kind. It is decided to substitute for that bridge a \$25,000 steel structure. Under the orders of the Interstate Commerce Commission we charge to capital account \$25,000 less \$4,000, the cost to renew in kind, or \$21,000. Originally there is the capital account containing \$2,000, representing the cost of that original bridge, to which we have now added \$21,000, making \$23,000 representing the cost of the present \$25,000 bridge, an undercapitalization of \$2,000 in that particular case. While it is small with each bridge, with a large number of bridges that are renewed and other structures that are renewed, it will amount to quite an item in the future.

By Mr. UTERMYER:

Q. You think the charge ought to be \$2,000?—A. Yes, sir.

Q. The original capital charge should be eliminated?—A. Yes, sir. That is where I personally would differ with the existing rules of the Interstate Commerce Commission.

By Mr. NEEDHAM:

Q. Suppose you renewed that bridge with the same type of bridge, what would you say then about the charge?—A. Charge to operating expenses.

Q. Your criticism is not that the renewals or repairs that have been made from time to time to the bridge should be charged to operating expenses, but that the total value of the bridge at the time of the renewal by a bridge of a different type represents more than the amount stated in the capital account?—A. Yes, sir. We have today a \$25,000 bridge there and only \$23,000 in the capital account on our books.

Q. Would not the same result occur if the \$2,000 bridge were repaired, say, arbitrarily—just giving arbitrary figures—at a cost of \$2,000. If it was renewed at the same time at a cost of \$2,000 and that charged to operating expenses, you would then have a more expensive bridge with only \$2,000 charged to capital account. Would not that be the case?

Mr. UTERMYER. I suggest, if your honor please, that we have spent quite considerable time on a hypothetical and entirely apparent question of what would happen in the case of a bridge. While it is entirely reasonable in cross-examination of an expert witness to take him into this field of questions, still we are not discussing the question of what would happen in the case of replacement of a bridge. I suggest to my friend that perhaps we might get on to the issue in this case. For that purpose I object to the question.

The Court. Counsel, of course, is allowed some latitude on cross-examination. I will ask counsel, however, to try to keep as close to the case as possible.

Mr. UNTERMYER. I only offer the suggestion. I really did not mean to make the point in an objection.

By Mr. NEEDHAM:

Q. Would not the same result occur if the \$2,000 bridge were replaced in kind with the same type of bridge at a cost of \$4,000?—

A. I do not think it is exactly the same result.

Q. Would not the same result follow that there would still remain in the capital account \$2,000 and the balance of it would be charged to operating expenses?—A. Yes, sir; but we are apt to confuse value and cost there. You have a more expensive bridge, but it is simply a renewal of the existing bridge. It is no more valuable. In the other case, it is a matter of construction. Additions and betterments are simply supplemental construction, and whenever any construction work is done the books should show the cost of the construction as an investment.

Mr. NEEDHAM. That is all.

By Mr. DENISON:

Q. I understand, in your opinion, the abandoned property should not be charged off at all in any account?—A. Abandoned, of the kind we are speaking of in this case?

Q. Yes.—A. That is my opinion.

Q. Is there any other kind of abandoned property that you think ought not to be charged off when it is abandoned?—A. Yes, sir.

Q. What other?—A. That ought not to be charged off, you say?

Q. Yes.—A. I do not recall any just now.

Q. As a general rule, when property is scrapped or abandoned, you charge it off in some way?—A. Yes, sir; but my position is that that is not abandoned. For instance, the Pittsburg & Gulf runs from Kansas City to the Gulf, and it still runs there after this improvement has been made, with a better and more efficient line than before. It is not like the abandonment of a spur to a coal mine, which coal mine has been worked out and there is no longer any use for the spur. There is just as much use for this railroad after these improvements have been made as there was before, and more, too.

By Mr. UNTERMYER:

Q. You would charge off that spur?—A. Yes, sir.

By Mr. DENISON:

Q. You would charge off the spur?—A. The spur to the coal mine.

Q. You would charge that off to profit and loss?—A. To profit and loss; yes.

Q. But when you abandoned these six actual pieces of real estate or land—I will withdraw the word "abandoned" because you did not accede to that—but when the railroad ceases to use these strips of land, you would still think that they should be carried as assets?—A. Yes, sir; as a part of the ultimate cost of the construction of the road. I think we are apt to confuse real estate there with railroads.

Q. And if there were a wooden bridge which had been replaced by another bridge, say half a mile away, would you still carry that wooden bridge as an asset after its use had been terminated?—A. You mean if that wooden bridge is a part of the line that has been—

Q. The line has been changed to a mile away, we will say, and the wooden bridge is no longer used, and the line has been entirely removed a mile away. Would you still carry that bridge as an asset?—A. If I understand your question, you mean that, for illustration, there might have been a wooden bridge on some of these lines that were revised, and left standing out there?

Q. Yes.—A. I would leave that in the cost of the property, just as much as I would leave the cost of one of those surveys in the beginning that was not used. It is all the same, whether we use the word "abandoned," whether you abandon it up and down, or laterally. If you put ten inches of ballast on your line, you have quit using that portion down below, but you have improved your line. If you cut down a hill, you have abandoned that part up there. It is the same thing.

Q. Is it the same? Is it not a fact that in the other case you have the same thing, but it has cost you more, whereas in the case we are dealing with you have a different thing?—A. It is a question of conditions as to which costs the most.

Q. Is there any other sort of property which you still think should be carried as an asset, without deduction, even after its use has been surrendered, than the sort of thing that this case involves?—A. My opinion is that the use of this is really not surrendered; that this is an existing part of the line from Kansas City to the Gulf, in the case of this road—this is a part of the cost of your line. The line still exists. If they abandon ten miles at either end of the line, then that should be taken out of the property account; but because you run your tracks a mile farther away and make an improved road, that is not an abandoned road. The road is still running between those two termini, and it is not analogous to a car thrown into the scrap heap.

Q. That particular part of the earth never feels the weight of the car and there are no wheels ever run over it, and nobody ever goes near it. What I want to get at is how you distinguish the principle between the surrendering or whatever you choose to call it, that was done in this case, of these pieces of land, and giving up an old locomotive and replacing it with a more powerful one.—A. As I have said, in the one case the locomotive is thrown in the scrap heap and reduces the number of pieces of your equipment by one.

Q. Is not this thrown into the scrap heap?—A. No, sir. It is being substituted by a better line. If you have 100 locomotives and destroy one, you then have 99 locomotives. You have one less locomotive than you had before, and it is proper to take that locomotive out of your property account when it is destroyed. You have a line from Kansas City to the Gulf, and you may transfer that line laterally or up and down, but you still have your line from Kansas City to the Gulf. It is not abandoned property.

Q. Have you still two lines? Is not that the point?—A. If you go back to the original surveys you might have six. Five of those surveys never felt the weight of a car.

By Mr. UNTERMYER:

Q. When you reduce the grade of the line of the old road, the earth that is removed never feels the weight of a car?—A. It never does.



By MR. DENISON:

Q. The portion of the old right of way here makes no contribution whatever to the dividends, does it?—A. I do not know that I am prepared to say that, because that is a part of the cost of the progress of the construction of the railroad.

Q. But to-day, you can not say, can you, that these old rights of way make any contribution to the income of the company?—A. In a sense, no; but in the same sense the present right of way may not. You have ground between your tracks and the fence on the side of your right of way that perhaps in the same sense makes no contribution to the earnings of the road. The contribution may properly be said, in its narrow sense, to be simply the two lines of steel that extend over the ties.

Q. If you were contemplating purchasing this line, you would not figure in the cost of the rights of way which are no longer in actual physical service, would you, in making up your estimate of what should be protected by a mortgage or what should protect a mortgage?—A. I have never bought a railroad, but if it were put up to me, a railroad with a five-tenths per cent grade would appeal to me as being worth much more than a railroad with a one per cent grade; and the object of these improvements has been to reduce the grade and the curvature, I assume, in some places.

Q. I am afraid you do not get my question. If you were to take a mortgage on the property of this railroad and you were estimating how much money you would lend on it, you would not count in the old right of way, would you?—A. Not specifically as such, but I have said that the improved road, with a lower grade, is more valuable than the old one with the higher, steeper grades.

Q. And you would not consider that the existing mortgage got any protection from the expense of the grading, etc., on the old right of way?—A. Not specifically as such, but of course the mortgage security is better with the improved line than it was with the old line.

Q. That is because it has not got the old line?—A. Perhaps.  
MR. DENISON. That is all.

By MR. NEEDHAM:

Q. Your reasoning would be the same with reference to changing the lines for the purpose of straightening it by taking out curves as it would be with reference to changing the line for the purpose of reducing grades, would it?—A. Yes, sir.

Q. If the total length of the line was reduced perceptibly by a certain number of miles, that would make no difference in your reasoning?—A. No, sir; because the short line between two points has a very large advantage and makes it a more valuable railroad.

By MR. DENISON:

Q. But as to the value of that short line, is it the value of the short line plus the old longer line? How can that be?—A. Because of the greater efficiency of service and greater capacity for the service.

Q. How is the shorter line increased in efficiency at all by the existence of the old roundabout line no longer there?—A. It is not increased by that.



## Redirect examination by Mr. USTERMYER:

Q. It is a part of the cost of progress?—A. Yes, sir.

Q. I suppose your insistence that the cost of the old property shall remain in the capital account in the case under consideration based on the assumption that the old construction was not a mistake, but was appropriate to the then existing development?—A. Yes, sir.

Q. If it was originally a mistake, that would be another matter?—A. Yes, sir.

Q. But you know when you are settling in a new country that you can not build the most expensive kind of line; it would not pay to construct it.—A. No, sir.

Q. So railroad construction has been an evolution?—A. Yes, sir.

Q. And the thicker the population, the more the country is built up, and the greater the needs of transportation, the more perfect and economical they must be.—A. Yes, sir.

Q. Do you base your opinion upon this question of averages, somewhat on the basis of the stages of building a house, where you put up a scaffolding in order to build the house?—A. Yes, sir.

Q. That scaffolding is a part of the capital construction?—A. Absolutely, and the scaffolding is used in connection with these same bridges.

Q. You look upon a wooden bridge as in a sense in these days a temporary construction?—A. Yes, sir.

Q. And in time it will be replaced by a steel bridge?—A. Yes, sir; steel or concrete or some permanent structure.

Q. Mr. Denison has just asked you if you abandoned part of the old line in order to shorten your road, whether the old line should remain in the capital account. You said it should?—A. Yes, sir.

Q. The good will of the property is built up by the initial line, is it not?—A. Yes, sir.

Q. That builds up the country and creates good will for the road?—A. Yes, sir.

Q. Is it not a fact the road could not exist at all but for the first construction—the inexpensive construction?—A. It is a fact; yes.

Q. And is it not that which enters as a large element into the eventual value of the perfected line when the country has been built up, that will permit of that perfected line?—A. Yes, sir.

## Recross-examination by Mr. DENISON:

Q. Would you apply those ideas to the main office building of a railroad company? Suppose the company should outgrow its original headquarters and should then build one in the next block, very much larger, and should sell the old one for half of its original cost, would you say the whole value of it should still be carried as an asset?—A. That is a condition I have never had to deal with before. I think in a case of that kind, offhand, and without giving it very much thought, I would say I would charge the entire cost of the new building to the capital account and credit capital account with the total amount of salvage from the old building.

Q. That is to say, you would deduct the loss there, and the ultimate result would be—A. (Interrupting.) No; the ultimate result would leave the difference between the original cost of the old building and

the salvage from that building in capital account, as representing the money that has been invested by the owners of the property.

By Mr. UTERMAYER:

Q. Did not these regulations, now in question, amount substantially to this, that where grade reductions are made vertically the entire cost of construction of the grade reduction goes to capital, and where they are made laterally according to the Interstate Commerce Commission they do not?—A. Yes, sir.

Q. That is practically what they amount to?—A. Substantially that.

Q. In principle there is no distinction whether they are made laterally or whether they are made vertically?—A. No, sir.

Mr. NEEDHAM. That is his opinion, you mean?

By Mr. UTERMAYER:

Q. Of course, we are asking for your opinion.—A. Yes, sir.

Q. That is all you are undertaking to give us?—A. Yes, sir.

Q. Suppose a man buys a house, a piece of land and an old structure. For the purpose of improving it he pulls down that old structure and puts up a new one. Is it your theory that the whole of that goes to capital?—A. Yes, sir.

Q. The value of the old structure as well as the value of the new one?—A. Yes, sir. If any salvage is obtained of course it is credited.

Q. Of course that goes off?—A. Yes, sir.

Q. Is it not a fact that prior to the promulgation of this order of August, 1909, it would have been illegal and improper to have charged these grade reductions to operating expenses?

Mr. NEEDHAM. I object to that question, if the court please.

Mr. UTERMAYER. I will ask another question.

By Mr. UTERMAYER:

Q. Is it not a fact that under the regulations of 1907 the improvements, such as we have here in question, were not chargeable to operating expenses?—A. That is my understanding. The operating expense classification made no provision for such, and up to this time I understand that classification makes no provision for such charges.

Q. It is under the head of additions and betterments?—A. Charged to additions and betterments, but I know of no provision made in operating expenses classification to take care of the charge that is proposed in additions and betterments classification.

Mr. UTERMAYER. That is all.

Witness excused.

L. A. JONES was thereupon called as a witness on behalf of the petitioner, and being first duly sworn, testified as follows:

Direct examination by Mr. UTERMAYER:

Q. What is your full name?—A. L. A. Jones.

Q. Where do you live?—A. In New Orleans, Louisiana.

Q. What is your profession?—A. I am vice president and comptroller of three railroad companies, the New Orleans & North-eastern Railroad, the Alabama & Vicksburg, and the Vicksburg, Shreveport & Pacific Railway.

Q. You are an auditor and accountant?—A. As comptroller, I am chief accounting officer of those companies.

Q. What has been your experience as railroad auditor and comptroller?—A. I have been engaged in railway accounting since '78. I have been chief accounting officer since October, 1895.

Q. Have you been engaged in railroads other than those in the present locality in the South?—A. Yes. I was assistant comptroller of the Cincinnati, New Orleans & Texas Pacific Company and the Alabama Great Southern Railway Company for six years, at the same time I was with these others—as assistant comptroller of those roads.

Q. So you are very familiar with railway accounts, are you?—A. May be said to be.

Q. Are you a member of the Railway Accountants' Association?—A. I am.

Q. You are also familiar with the issues involved in this controversy, are you not?—A. I am.

Q. You know the question here in issue is as to whether or not these grade reductions should be charged against operating expenses made off the line of the original road?—A. Yes, I do.

Q. Will you be good enough to state your opinion as to whether or not they are properly chargeable to operating expenses, or any of them?

MR. NEEDHAM. It is understood, your honor, I suppose, that all his testimony, so far as it goes to the expediency or judgment of the commission, as to which is the proper way to charge this off, is objected to. If it is introduced, as I understand it is, for the purpose of showing that the order of the commission was in itself arbitrary or the reason that it does not rest upon reason, then I have no objection to it.

THE COURT. I do not suppose his opinion would affect the power of the commission to make a rule or regulation, or would interfere with their judgment as to its wisdom. I suppose it is being introduced for the purpose you indicate.

MR. UNTERMYER. Entirely on that issue.

THE WITNESS. Be good enough to read the question, Mr. Stenographer.

THE STENOGRAPHER (reading):

Will you be good enough to state your opinion as to whether or not they are properly chargeable to operating expenses, or any of them?

THE WITNESS. I think the cost of the new work should be charged to the cost of property, and that the cost of reproduction of the old property less the salvage recovered should remain also in the cost of the property.

By MR. UNTERMYER:

Q. Will you state your reasons for that conclusion?—A. As I consider it, the cost of the original property was properly shown as cost of property, and the existence of that original property rendered it possible, by its credit and by its good will, to improve the property through additional securities, and therefore it is a step in the completed property just as much, even though the property be not actually used physically by the trains, as though it were used. It is an essential step in the building up of the present property.

Q. In other words, you could not have started with a property of the character of the present property? The country could not have

afforded it?—A. I know of no railroad that was built to what may be termed the highest standard of efficiency at first. It is built at a standard which is warranted by the conditions of the country and the traffic afforded at that time, and as the development of the country warrants, the financial condition of the company permits, and the needs of the traffic require the property is developed and improved in its standard.

Q. You are aware, are you not, that you could not get the money—if it would cost a million dollars to improve a property—and half of it were to go off as a charge for abandoned property, leaving one-half of the million dollars with which to make a million dollars of expenditure? You could not get the money to make it under those circumstances, could you?—A. I think it is perfectly clear that you could not borrow a million dollars to make an improvement which cost a million dollars if you had to write off half of the million dollars. The terms of mortgages on which money is raised usually provide that that money shall be spent on improvements. It would not be proper under those mortgages to build them with that money under those circumstances.

Q. What would be the effect upon improvements and betterments and the increases in efficiency with the railroads of the country if such a regulation as is here in question were put into effect, in your judgment?—A. Unquestionably it would be to restrict improvements.

Q. Practically paralyze improvements, would it not, except with very rich roads that could do it readily out of earnings or that had large borrowing powers?—A. I think so.

Mr. UNTERMYER. That is all.

Cross-examination by Mr. DENISON:

Q. Do you know that this road carried to profit and loss \$827,000 in the fiscal year ending June 30, 1911?—A. I did not.

Q. Assume that for each fiscal year from and including 1907 to 1911 it had carried over a balance to profit and loss, after paying dividends and all other charges, of an average of \$800,000, is there any reason that that could not be applied to such improvements as this, costing \$600,000?

Mr. UNTERMYER. I shall have to object to that. Your honor is not familiar with the proof already in the case, perhaps. The proof already in the case is that under our charter the preferred dividend can only be paid out of current earnings.

Mr. DENISON. That is, after current earnings have been paid.

Mr. UNTERMYER. If we are going to make an improvement of \$600,000 this year and it is going to be charged in operating expenses we can not go to our surplus fund to pay our dividend.

Mr. DENISON. The witness has testified this kind of an improvement could not possibly be made. I want to know what he knows about it.

The WITNESS. Did I testify they could not possibly be made? I would like to hear that question and answer read.

By Mr. DENISON:

Q. I may have misunderstood. I understood you to say in your testimony that this kind of an improvement would be prohibited by this kind of thing, if required.—A. I do not think I said so. I say

that the effect of that provision would be to restrict additions and betterments very much. A railroad may be in such financial condition that they could make such improvements, but generally they are not. I am not prepared to testify as to the financial condition of the Kansas City Southern Railway.

Q. Do you know of any reason in morals why a railroad should be permitted to enlarge its mortgage indebtedness a million dollars for the purpose of increasing its capital account only half a million dollars?

Mr. UXTERMYER. I object to that question, your honor.

The COURT. Morals are in the case, but the objection is sustained.

By Mr. DENISON:

Q. What I wanted to inquire about was whether the state of the surplus of the railroad has not something to do with the question of its power to make this kind of an improvement.

Mr. UXTERMYER. I object to that. Does not that depend upon its charter and mortgage provisions, and all the rest? Here you have a case in which we have to have \$200,000 a year sinking fund. We can only pay preference dividends out of current earnings under our peculiar charter. If this year we have \$600,000 in the way of grade reductions and it all has to come out of operating expenses, or any material part of it, we could not pay our dividends, no matter what our surplus is. It might be a very material question, your honor, if the proposition were that these improvements should be deducted from our surplus. That is another proposition. The proposition of this rule and regulation is to take them out of our current earnings and call them operating expenses. The charters which have been put in evidence show what the legal situation is. I hardly suppose we can get anything from this witness on that.

Mr. DENISON. The witness has been asked to testify and has testified, as I understand it, that the existence of this rule of accounting would practically prohibit this sort of improvement.

By Mr. DENISON:

Q. Is that your testimony?—A. I say it would largely restrict it.

Q. Would it restrict it at all unless the railroad was unable to do it except out of borrowings?—A. I think it would be an unusual condition when improvements were made out of other than borrowed funds.

Mr. DENISON. That is all.

By Mr. NEEDHAM:

Q. As I understand your position and the position of those who agree with you, it is that this rule has the effect, first, to reduce the property accounts, and, second, to inflate for a time the operating expenses. Is that correct?—A. My position is that the charge to operating expenses is wrong, regardless of the effect. Regardless of effect, the charge would be wrong, because operating expenses are intended to cover the cost of operation and the cost of maintenance of the property, and this is neither. I think it should be left in the cost of the property, because it was a step in building up the property as it exists.

Q. You stated that you thought it would prevent the raising of money or the borrowing of money. Is that because it would reduce

the property account?—A. The money would be borrowed under a mortgage which would provide for the disposition of the funds raised. The provision of the mortgage would be that the money should be spent on improvements under certificate from the officers of the company. If, in connection with that, you should write down the cost of the other property built out of moneys obtained from former mortgages, you in effect countervail the condition of that mortgage under which you raised the money, and you could not properly give that certificate.

Q. So far as the credit of the company is concerned, I understood you to say that it would reduce the property account, and that they could not borrow, say, \$1,000,000 unless they could increase the property account that amount or approximately that amount.—A. In effect, the mortgage would provide for the—

Q. I am not asking what the mortgage would provide.—A. I merely wish to explain. Perhaps I do it unfortunately. You could not obtain the money except under the promise that you would do a certain thing. Under this provision you could not do that thing; therefore you could not get the money.

Q. Why could you not do it?—A. Because you would be obliged, instead of expending it in additions and betterments, to expend it in operating expenses.

Q. That is, you are expending it for what should be charged to operating expenses on the theory of the Interstate Commerce Commission rule?—A. Yes.

By Mr. UENTERMYER:

Q. In other words, you can not borrow money on mortgage for operating expenses. That is so, is it not?

Mr. NEEDHAM. What do you mean by "can not do it"?

Mr. UENTERMYER. People do not sell bonds and people do not buy bonds that are issued to pay operating expenses of a railroad.

Mr. NEEDHAM. You are speaking of it as a practical question?

Mr. UENTERMYER. Intensely so.

Mr. NEEDHAM. Not that that is the law.

The WITNESS. It has not been my experience that we could do that. I never tried to do it, as a matter of fact, because I thought it would be precluded if I wanted to.

By Mr. NEEDHAM:

Q. You have heard of instances, I suppose, where an operating expense of a road or the operating expenses of a road have run it into debt so that it had to borrow money to float itself, have you not?—A. I have heard of railroads running themselves into insolvency.

Q. Without that?—A. And using other funds for it. But under an improvement mortgage you are obliged to certify to the expense in order to get bonds for sale.

Q. You are speaking with reference to a particular form of mortgage all the time. I am trying to call your attention to the credit of the road as represented by its property account. Do you think the credit of this road, for instance, would be affected one way or the other by charging \$386,484 to operating expenses rather than leaving it in the property account, provided the whole fact is known

the public?—A. From the testimony that was given this morn-

Q. (Interrupting.) Can't you answer my question?

Mr. UNTERMYER. Won't you allow him to answer it?

Mr. NEEDHAM. No; I will not allow him to answer it in that way.

Mr. UNTERMYER. Your honor, the witness should be permitted to answer the question.

Mr. NEEDHAM. I have a right to have my questions answered. These talks about mortgages of a particular form have brought out this question. This is a question that is easily answered.

The COURT. Let the stenographer read the question and let the witness answer it.

Mr. UNTERMYER. My only objection is that it does not seem just to cut off the answer.

The COURT. You can bring it out in some way.

The STENOGRAPHER (reading):

You are speaking with reference to a particular form of mortgage all the time. I am trying to call your attention to the credit of the road as represented by its property account. Do you think the credit of this road, for instance, could be affected one way or the other by charging \$386,484 to operating expenses rather than leaving it in the property account, provided the whole fact is known to the public?

The WITNESS. I should think it would.

By Mr. NEEDHAM:

Q. The reasoning upon which you have based your opinion with reference to the charge of this item to property account rather than to operating expenses would apply equally to charges made to take out curves which might result in shortening the road?—A. Certainly.

Q. And it would apply also to the cases where structures on the line of the road were substituted by structures of a higher type?—A. That would depend upon the condition of the structure at the time it was substituted. The operating expenses ought to reflect the cost of maintenance of the property, and to the degree that the replacement covered up a maintenance there would be a proper charge to operating expense.

Q. How would you arrive at that?—A. I should say that that is one of the cases that should be left to the discretion of the road in a particular case. I think it would be almost impracticable to provide a hard and fast rule that would take care of those cases.

Q. That is as to the amount of it?—A. Yes. In principle, operating expenses should take care of the maintenance of the property.

Q. But the fact that a structure has been substituted by a structure of a higher and better type would involve the charging of some of that to operating expenses and the taking it out of the property account?—A. That altogether depends on whether—it is very difficult to generalize these things, but I am endeavoring to meet your question as carefully as I can. The cost of the property ought to reflect the cost of the necessary stages of building it up, and the operating expenses ought to take care of the maintenance. In order to answer any question accurately, it ought to be put in a specific case.

Q. Take a case where the existing structures are not regarded as sufficient to carry the business and they are replaced or any of them are replaced by structures of a higher type; would you say that any



part of the cost or value of the old structures should be deducted from the property account?—A. If the structure replaced were in substantially good condition, I think not. If it were replaced because it had been worn out, I think it should.

Q. What do you say of the case where the existing structure was not regarded as safe to carry improved and heavier equipment, although sufficient to carry the old equipment?—A. I think it should be charged to the cost of property.

Q. In the entire amount?—A. I think so, if the present structure were in substantial good condition and had been well maintained.

Q. You would not deduct anything in that case from the property account on account of the old structure or structures which were abandoned?—A. I would have to know the condition of the structure abandoned, but if it were in substantial good condition I would not deduct anything.

Q. That is, if it were in substantial good condition to carry the traffic with the old equipment you would not deduct anything from the property account?—A. No; I do not think so.

Q. You would charge the entire cost of the new structure to the property account?—A. Yes.

Q. Then you would have in your property account the cost of two bridges, the old and the new?—A. I would have in my property account the cost of a road which had enabled me to rebuild the new bridge.

Q. You would have in your property account the cost of two bridges, would you not—the old bridge and the new one?—A. I would; yes.

Q. Your theory of the accounting is that that is correct, to carry the cost of two bridges?—A. If the one is a step toward the building of another, as it would be in this case, I think it is correct theory.

Q. But before the discovery of steel and the building of steel bridges, wood was considered a permanent structure, was it not?—A. No; I can not say that it was considered a permanent structure.

Q. Was it not so considered at the beginning of railroad construction?—A. No; it was considered the best that offered.

Q. Was there anything else in view?—A. Stone arches; yes. There were iron bridges, if you wish to differentiate between iron and steel.

Q. I simply want to get at your view. Do you mean to state that in the early construction of railroads in this country they put in wooden bridges of a permanent character as a mere stepping stone to steel bridges?—A. No; not at all; but they knew they were not permanent.

Q. What do you mean by that?—A. They knew that would have to be replaced from time to time, and they improved in the type of wooden bridges.

Q. That is true of steel, is it not?—A. Yes.

Q. Every steel bridge put in may be improved in type and strengthened?—A. Yes.

Q. Can you consider any structure or construction permanent in the sense in which you are using it?—A. We have reached the opinion that concrete is permanent. I do not know whether it will prove so.



With reference to wooden and steel bridges, it is generally understood there may be still further improvements made?—A. Certainly.

Then you would go on indefinitely for all time adding the of bridges and structures to the property account and keeping the old structures in the property account?—A. (Interrupting.) at all.

Wait a moment: you did not get my question.—A. I beg your pardon.

(Continuing.) Provided at the time the change was made the structure was in good physical condition, but was out of date or out of use?—A. I would not build in that way. I would not discard a good bridge, because wooden bridges are not so permanent in their nature that they can not be replaced as they wear out.

Is it not a fact that the increasing of the cars from twenty and twenty-five tons to fifty tons, and the increasing of the weight of the engines to carry such trains of cars have necessitated the change of structure of the road?—A. Yes; but that has come along gradually, and the railroads have increased their bridges gradually.

But they have changed them because of that fact, have they not?—A. Yes. They have changed them with the expectation of changing the type of their engines and cars.

Those changes were made then not because they had worn out, you have stated, but because they were out of date with reference to the future traffic?—A. No; they were made for both. They were made at the time they wore out for the purpose of taking care of the increased weight.

Do you mean to say that no structures have been replaced solely for the purpose of taking care of the increased traffic and the weight of the equipment?—A. So far as the lines I am connected with are concerned we never have been able to do it except in that way. We simply replace structures that have reached a limit where it would be unwise economically to repair them and renew them. At that time we improve the standard.

You increase the type. Are you carrying on your roads 50-ton cars and engines of that type that are used to carry that kind of a train?—A. We increase our engines as the bridges have been increased, and only then. For the most part we do not get the very heavy loading for the cars, but we are obliged to limit over certain parts of our line the load which we may carry.

Then you are limiting your roadbed improvement to the equipment which you carry?—A. Perhaps we had better put it this way: We are carrying on improvements as fast as we can, but we find it takes all our resources to take care of it as it wears out, so we are unable to do both things.

Is it not a fact that upon certain roads, and especially throughout the East, where the heavy traffic is carried and larger cars and engines are used, it has been necessary to entirely rebuild the roadbeds?—A. I am not in a position to testify on that.

You can not answer that question?—I am not in a position to testify on that.

Coming back to the statement that if the bridge or structure were worn out or partly worn out, so as to need reproducing, and it

was reproduced by a bridge of a higher type, will you state again how you would state that account with reference to the property account and the operating-expense account?—A. The operating expenses should bear the measure of wear on the old bridge and the cost of property should bear the additional cost in the bridge of the higher type. There is a condition there that is sometimes difficult to reconcile. The commission has, I believe, made the excess cost of the new structure chargeable to additions and betterments—the excess cost over cost of reproduction in kind. Whether that or the excess over original cost would be the proper measure is open for discussion. But operating expenses should bear the cost of replacing that bridge, if it were replaced in kind, and therefore it is not unfair that it should bear it if it were replaced in a higher type.

Q. To what extent?—A. To the extent of the cost of the former structure or the cost of reproducing the former structure.

Q. That would operate in the net result, then, of deducting from the property account the then value of the old structure?—A. Yes.

Q. That would be the net result, I mean?—A. Yes, sir; it would be the net result—because, as a matter of fact, it would be worn out.

Q. You would say that was the reason for making the charge in that way?—A. Yes.

Q. How do you differentiate that case from the case where a certain portion of a line has become obsolete because of the inability to carry over it traffic of the road and it becomes necessary to abandon it and build a new piece of road for the purpose of meeting new requirements of the railroad and traffic?—A. I do not see any conflict in these two statements at all. You have a railroad built to do the same business between the same two points. You are not abandoning anything. You are simply, at an increased cost, acquiring an increased property.

Q. You do abandon part of the line the same as you abandoned the old bridge, do you not?—It goes out of use.—A. I do not think it is abandoned at all.

Q. You are giving some technical definition for the word “abandoned.”—A. No.

Q. You do, in fact, cease to use that territory in the road the same as you cease to use the old bridge. Is not that so?—A. No; I do not think so.

Q. If the old line is upon what I have termed a curve and you straighten that, you certainly abandon the curve, do you not?—A. Of course the track is not laid over the same earth, and if you use it in that narrow sense, you do abandon that portion of the line outside of the rail. But you still have the road serving the same purposes between the same two places. When you put another bridge in you do not do that.

Q. Let us see, with that explanation of the differences in the meaning of the word “abandoned,” if we can agree on the facts. Let us assume a line of road from A to point B on a curve, and for the purpose of improving the road they build a straight line from A to B. They take up the rails of the old curve. There can not be any question that they have abandoned the curve, can there?—A. You can put it that way; yes. They have abandoned the curve and they have used the straight line instead.

Q. There can be no question about that fact as a fact, can there?—  
No.

Q. What is the difference between abandoning that curve and abandoning the old bridge, which they do not use any more?—A. I think that must be very apparent. It is to me.

Q. It is not to me. I wish you would explain it so I will understand it. In both cases they still have the railroad running between the same points.

Mr. USTERMYER. Do you want him to explain it?

Mr. NEEDHAM. Wait a moment; let me complete my question.

By Mr. NEEDHAM:

Q. In both cases they have the railroad running between the same points. In one case they abandon the bridge because it is not serviceable. In the other case they abandon the curve because it is not serviceable. Will you tell me what the difference is?—A. The road in its essentials runs between the same points and handles the same traffic, has the same property that it had before, with the additional property that it acquired in the building. It owns it all. It has not abandoned it. It is using a portion that is needed for the tracks, and while it is not technically using the portion that is abandoned, that was an integer in building up and getting the other, and to all intents and purposes it is used just as it was before.

Mr. USTERMYER. If the bridge is in good condition, you do not charge that off?

Mr. NEEDHAM. Wait a moment. I object, your honor, to this interference with the witness. The witness is not through with his answer.

Mr. USTERMYER. Let him complete his answer, then.

By Mr. NEEDHAM:

Q. Will you proceed?—A. In the case of the bridge, if the bridge were absolutely new and in perfect shape, as the track was substantially in perfect shape for the needs of the traffic, and if you built a new bridge of a higher type, as you build a new track of a higher type, it would be proper to charge the entire cost to capital. If the bridge was worn out, it is not improper to charge the wear to operation.

Q. What is the difference between a worn-out bridge and a worn-out curve?—A. The curve was not worn out, as I understand it. It simply needed a higher class of track between the two points.

Q. Is that the whole of your answer?—A. That is all.

Q. You make no distinction, then, between the depreciation of a railroad by reason of the fact that its grades and curves have become detrimental to the present-day and future traffic and the case of structures which have become detrimental to it?—A. What do I understand by the structures being detrimental to it?

Q. They have to be improved by new types. You say if the old bridge is a good one and it is improved, you do not think it ought to be taken out?—A. I do not say it ought to be taken out, but I think the cost of the new one ought to be charged to the cost of road.

Q. And that the old one should not be taken out and no part of it charged to operating expenses?—A. No.

Q. In that case the fact that the structure is of an old type makes it a detriment to the present and future business of the road. Is not

that true—and the new one is put in for the purpose of improving and getting new conditions?—A. It might be.

Q. Is not that the fact? Would they substitute a new type of structure—a bridge, for instance—for an old bridge that was in good condition, for any other reason?—A. So far as I am concerned, they would not do it on our property. If the bridge was in good condition you would not substitute. It is a purely theoretical question you are asking me, so far as I am concerned, from my experience. If the bridge were worn out, then, when we replaced it, we would want to take advantage of the opportunity to replace it with a higher type.

Q. I understand, and then you stated in addition to that that if the replacement of a bridge of a higher type was for a bridge that was in good condition, you would leave the cost of the old bridge in the property account and put into the property account the cost of the new one?—A. I think that would be proper in such a case.

Q. That would not be done, would it, in any instance except to meet the demands of present-day and future traffic of the road?—A. I do not know why it would be done.

Q. Can you conceive of any other reason why it would be done than to meet the demands of traffic over the road?—A. I suppose that would be the reason, but that is theoretical so far as

Q. (Interrupting.) There is nothing theoretical about it, is there? It is being done every day. —A. Not with us.

MR. UTERMAYER. As a rule, it is not being done where the bridge is in good condition.

MR. NEEDHAM. No; he does not state that.

MR. UTERMAYER. Where the bridge is in good condition, I say.

MR. NEEDHAM. That is not true. Roads have been rebuilt entirely for that very purpose, and it is well understood.

MR. UTERMAYER. I do not agree with you.

By MR. UTERMAYER:

Q. Do you agree with that, Mr. Jones? —A. I do not.

By MR. NEEDHAM:

Q. You do not say, then, that roads have been built in this country and that there are roads in this country that have been rebuilt, so far as their roadbeds have been concerned, in order to carry 50-ton cars and larger engines for the purpose of carrying that traffic? Do you want to go on record as stating that?—A. I do not say that.

Q. Then state what you do mean by your answer to that question.—A. If you mean the condition when the property has reached a stage which would warrant it, they do take these portions that are worn out and improve them, and in doing that, in the course of the improvement, they can progress regularly to an improved type. It may be, and I believe you are warranted in saying, that there are cases where, in order to make progress, they have ruthlessly put aside some structures that have still a large measure of use in them.

Q. Do you not know that is a fact?—A. I believe it is a fact.

Q. Yes?—A. But not generally.

Q. I do not know what you mean by "generally." —A. I mean that is the exceptional case rather than the rule.

Q. Let us deal with that fact, admitting that it is a fact. The reason, then, of the change in a case of that kind is that the older

structure has become a detriment to carrying the traffic with larger cars and engines. Is that a fact?—A. I suppose so.

Q. Suppose that on a road of that kind, where such improvements are being made, there is a curve which is equally a detriment to the carrying of that traffic and it has to be abandoned and a new or straighter line put in its place, how do you differentiate in that case between a bridge and a curve as abandoned property?—A. I do not differentiate. I think the cost of the straightening of the line and eliminating the grades off the right of way, as on the right of way, should be charged to cost of property, and in the bridges and so on, if it is a new structure, I think you would be warranted in charging the increased cost also.

Q. Have you continued that process of adding to the cost of the property account indefinitely?

Mr. USTERMYER. I think you have asked that two or three times.

Mr. NEEDHAM. I am going to ask it again.

The WITNESS. If the principle is correct, it is correct.

By Mr. NEEDHAM:

Q. Is that your position?—A. I think so.

Mr. NEEDHAM. I think that is all.

Redirect examination by Mr. USTERMYER:

Q. Do you see any analogy at all, Mr. Jones, between the case of a worn-out bridge and discarding the right of way in order to make grade reduction?—A. I do not.

Q. The right of way does not wear out, does it?—A. No.

Q. And you are assuming, of course, that the discarded or abandoned right of way has been maintained and kept in good condition?—A. Yes.

Q. It has not worn out?—A. No.

Q. That is part of your premises, is it not?—A. It was testified to this morning, and I assume it was correct.

Q. Then is it to your mind a manifest inconsistency between this attempted discrimination between grade reduction on the original right of way and one off the right of way, whereby one is added to the cost of construction and the other is differently dealt with?—A. It is. I see no reason why they should not be dealt with on the same lines.

Q. That is, a vertical grade reduction should be dealt with in the same way as a lateral grade reduction?—A. Yes, sir.

Q. You were asked some questions with respect to the effect on earnings and on the credit of the company, of this method of dealing with accounts here in question. Is or is not the credit of a road very materially affected by its ability or nonability to pay its preferred dividends?—A. It is very materially affected.

Q. Its borrowing capacity is very much crippled, is it not?—A. It is.

Q. Mr. Denison presented some figures to you. Suppose a road is in the situation of this road, in which its dividends on preferred stock can only be paid out of its current earnings, and not out of its accumulated surplus or in any other way, what effect, in your judgment, would the enforced charging against operating expenses of the character of improvements here in question, so that the road

could not show an earning on its preferred stock, have upon the credit of the road and ability of that road to continue its improvements?—A. If the charge were such as to reduce the available surplus for dividends to a point where the preferred stock could not be sure of a dividend, it would seriously cripple that road, and it would affect its ability to sell bonds.

Q. Would not such a charge against operating expenses of such improvements have also the effect of great injustice to the preferred stock holder whose dividend was not cumulative?—A. It would.

Q. It would paralyze improvement, would it not, and make it impossible to carry on the road?—A. It would damage its credit. As it damaged its credit it would retard its improvement.

Mr. USTERMYER. That is all.

Recross-examination by Mr. NEEDHAM:

Q. Where the road is in good condition physically, whether a policy of improvement of this character should be adopted and entered upon would depend largely upon the prospect of its increasing the traffic or lowering the expenses, or both, would it not?—A. Yes; I think so.

Q. If it would not increase the volume of the traffic or would not materially reduce the cost of operating the road, the road would not be justified in making an improvement of this kind?—A. Presumably not.

Q. If it could show with reasonable certainty, as such things are shown for the future, that by making this grade reduction it would increase the volume of its traffic and would decrease the cost of moving that traffic 50 per cent, would not that fact itself increase the credit of the road?—A. I think it would if the dividends were maintained on the stock; but if the dividends were interrupted, I doubt the ability to impress the public with these future benefits to the extent of taking on securities.

Q. Then it would depend, in your mind, in a case of this kind, upon whether or not it would interrupt the payment of dividends—assuming my proposition?—A. What would depend?

Q. Whether their credit would be improved?—A. Yes. I do not think credit is improved so much by future prospects as it is by present results.

By Mr. USTERMYER:

Q. It depends a good deal on the margin shown over and above the dividends, too, does it not?—A. Yes; of course.

Q. If you take out vast sums from the operating revenues, and thus reduce the margin over the expenses, that would reduce the credit—

Mr. NEEDHAM (interrupting). I had not gotten quite through with the witness, although I do not object to your going ahead. We are getting a good deal of information here.

Mr. USTERMYER. I do not think we are.

Mr. NEEDHAM. I had thought so.

By Mr. NEEDHAM:

Q. Suppose an improvement upon a road were proposed which had to be made entirely upon borrowed money, and that borrowed money increased the fixed charges sixty thousand dollars per annum, and that fixed charge would prevent the payment of dividends already existing, do you say that would affect their credit favorably or

unfavorably?—A. Unfavorably. I think it would be necessary for them, before undertaking that sort of improvement, to provide the whole sum necessary to carry the work to conclusion, so they would not have to borrow a second time until they had resumed the payment of dividends.

Q. Suppose at the time of borrowing it could be shown that the increase of the fixed charge of sixty thousand dollars a year would prevent the payment of existing dividends based upon the existing traffic, would you say that would affect the credit of the road?—A. Yes; I think it would.

Q. Do you think they could borrow money on a proposition of that kind?—A. No.

Q. It is not a question of how it is accomplished, whether by increasing the bonded indebtedness and fixed charge, or whether it is accomplished by charging part of the cost to operating expenses. It is a fact that by that process, or either one of them, the existing dividends are interrupted and the credit is impaired, you say?—A. I think that would be a tangible thing.

MR. NEEDHAM. That is all.

Redirect examination by Mr. USTERMYER:

Q. If you could make a showing of large earnings and did not have to make vast charges against operating expenses for these grade reductions, so your showing of earnings was large, that would assist in the borrowing capacity, would it not?—A. Yes.

Q. Even though you did not pay dividends, if you showed you had earned a large surplus, that would help your borrowing capacity?—A. If you had been paying dividends, the negotiations were such as to enable you to make the improvements which promised future returns without impairing those dividends—is that your question?

Q. No. Suppose you did not pay the dividends, but showed the earnings; that is, you did not have to make these large charges to operating expenses; that would help your credit, would it not?—A. I think your credit would be impaired if you went off the dividend basis.

Q. A suspension of dividends would injure the credit, but if you showed you had earned the money, even though you did not pay the dividend, your credit would be better than if you did not have that margin?—A. If you earned the money and did not declare the dividends it would be better than if you did not earn it, undoubtedly.

Q. If you did not have to make those charges to operating expenses, that would increase your showing of earnings?—A. And that would also permit you to pay the dividends.

Q. They might or might not; but whether they did or not, the point is that your financial status would be assisted by not having to charge these items to expense?—A. Unquestionably.

Q. I want to ask one question I forgot to ask before. What is the effect of these regulations upon the very rich and prosperous roads that want to keep down their apparent net earnings and dividends?—A. I do not know.

Q. What I mean is as to whether these operations offer a cover, under the guise of operating expenses, for very large improvements, to keep down apparent earnings?—A. They would do so.

Q. And would that not have the effect of enabling high freight rates to be preserved on a basis of lower earnings than the actual earnings, by covering them through these large items of operating expenses?—A. Apparently so, if rates are regulated on the earning capacity.

Q. Assume, for instance, a supposititious case of the Union Pacific making grade reductions to the extent, we will say, of ten million dollars and making them off the line of the old road, so they would all be chargeable against operating expenses; the effect of that would be, would it not, to show an apparent profit less than the real profit and to permit the maintenance of higher rate charges; is that true?—A. I think it would be true; yes, sir.

Mr. NEEDHAM. We set that all up; there is no question about it.

Mr. USTERMYER. You are putting a premium upon higher rate charges by your proposed method.

Mr. NEEDHAM. We meet that proposition.

Mr. USTERMYER. That is all, Mr. Jones.

Witness excused.

S. M. HUDSON was thereupon called as a witness on behalf of the petitioner, and being first duly sworn, testified as follows:

Direct examination by Mr. USTERMYER:

Q. Will you state your full name?—A. S. M. Hudson.

Q. Where do you live?—A. Fort Worth, Tex.

Q. What is your profession?—A. Railway accountant.

Q. What is your present occupation?—A. I am auditor of the Fort Worth & Denver City Railway and under title of consulting auditor I have charge of the accounts of the Wichita Valley Railway lines.

Q. What has been your experience as a railway auditor and accountant?—A. I have been handling railway accounts for about 20 years.

Q. You are familiar with these regulations here in question, are you not?—A. Yes, sir.

Q. Please state to the court your opinion as to whether these grade reductions off the line of the original road at the six points shown in the petition here are or are not properly chargeable to operating expense?—A. I do not think they should be charged to operating expense.

Q. Be good enough to state the reasons for your opinion?

Mr. NEEDHAM. That is not a correct statement of the fact, your honor.

Mr. USTERMYER. Do not waste any time in discussion. We will modify it in any way you want it.

Mr. NEEDHAM. I do not think we disagree about the facts. I simply do not want the record to be filled here with a misstatement of fact. It is not a question whether the whole cost of the improvement should be charged to operating expenses. It is simply a question, as I say, of bringing out by calling the attention of the witness to this Exhibit B to determine whether or not the value of the abandoned property, less the salvage, should be charged to operating expense account. That is a very different thing. In this case they made an improvement that cost \$700,000, but under the rule the



amount which they are required to charge to operating expenses is \$286,000. The question is entirely wrong in its assumption.

By MR. UNTERMYER:

Q. You understand the question to be one of charging the total cost of the grade reduction off the line, less the value of the so-called abandoned property, do you not?—A. You asked the question in bad shape, it seems to me.

Q. How do you understand the problem?—A. You mix up the question of cost the way you put the case.

Q. State the problem as you understand it.—A. As I understand it, the total cost of the improvements is chargeable to property account. It is paid for by charging expenses—that is, the order covers that—and setting up a fund to pay for the improvement and reducing the old property account, and the balance is taken care of by new capital expenditures. The result is exactly the same, no matter which way you state it.

Q. You understand the problem. The question is whether you agree and what is your opinion as to whether or not the value of the old so-called abandoned property is properly chargeable to operating expenses?—A. There is no charge that should go to operating expenses on account of the stopping of the use of the old property.

Q. State your reasons for that opinion.—A. My reasons are based on the necessity, absolute necessity, of two things—the integrity of the property cost and the integrity of income.

In the income there are a great many interests, and they are conflicting interests, and for that reason the income should be stated very carefully and correctly.

You have your gross revenues, and as against that you should charge the costs of producing those revenues. The cost includes not only operation, but full maintenance of the property, so that at the close of a period in which you are stating your account the property is in as good condition as it was at the beginning.

Any increase in the charge against revenue, thereby reducing the net earning ability, is a fraud on somebody, because, taking the owners of the property and the stockholders, they have a two-fold interest: First, in the property, and it is their interest that that should be fully maintained; they have a second interest, and that is an income interest. It is their interest that, having the property fully maintained, they should have their full income. If you charge any portion of the investments which they make against that income they are the owners that are paying it. You are reducing their income by that charge, and that is wrong. They have a right to the full amount of that income. That is my reason for the opinion which I have expressed.

Q. Then you regard, do you not, the so-called abandoned property in the case of grade reduction off the line of road, where it has been maintained and in good condition, as part of the cost of the property?—A. If the property already in service is wholly maintained and the cost of that maintenance has been charged against revenues, I do not know of any reason whatever why you should charge revenues with anything additional.

Q. It is not really an operating expense at all, is it?—A. If you lose that property or abandon that property or give it away—although I think “abandoned” is in a way the best term to use—still they use it in different places which are wrong—

Q. (Interrupting.) You think it is not the best word?—A. I think it is as good as any.

If you give up this property in order to better the capacity of your plant, either by increasing the amount of traffic it can handle or by reducing the cost of handling that traffic, that additional cost is additional investment cost.

Q. You are assuming these are improvements of investment?—A. Yes, sir; and you are asking my reason.

Q. And you are assuming also, I suppose, that the original construction was in conformity with the needs of the times and was not a mistake?—A. Certainly. But, regardless of that, that is an additional investment which you have made, whether it is profitable or not.

Q. You think it all belongs in cost of property?—A. Yes, sir; provided always that the property as originally built has been fully maintained through the charges to revenues.

MR. UNTERMYER. That is all.

Cross-examination by Mr. DENISON:

Q. Suppose you find a little device by which the operating charges can be reduced and thereby the income eventually increased to the stockholders—is there any injustice to the stockholders in charging that temporarily to the operating expenses when it is for the benefit of the increased eventual income?—A. I do not know of anything that could be classified that way.

Q. It has been testified here that the purpose of these changes was to decrease the expense charges against the stockholders?—A. Yes, sir.

Q. And that it has had that effect, to decrease those charges. Is there any injustice, that being so and the whole purpose and effect of the change being to increase eventually the net income to the stockholders? Where is the injustice in charging that temporarily to operating expenses?—A. The stockholders, in going to the additional expense of putting in these betterments, have put so much of the charges ahead of their rights—put certain charges, at least, ahead of their rights to income. Why should they put in anything more? Simply as a straight business proposition, for illustration, suppose you have a line which has cost you ten million dollars. You are earning five per cent on that amount, regardless of how you are distributing that between bonds and stock. You believe that by the expenditure of one million dollars more you can earn six per cent on eleven million dollars. That is the only justification there is for the additional expenditure. If, in order to write off that one million dollars, which is the equivalent of what is in the old line, you have to make a charge ahead of returns to the stockholders, the stockholders are the owners that are paying it back to themselves by a reduction of their income. It does not make any difference; every cent that is earned over and above the fixed charges and operating expenses and maintenance of the property is income to the stockholders. It is all there is. It may be five per cent or may be fifteen

per cent. If you compel them to give up part of that for any reason, you are taking their money away from them.

Q. But suppose they come out just as well in the end? Suppose you find that by taking thirty thousand dollars out of operating expenses for each of ten years—A. (Interrupting.) You mean adding?

Q. Yes, sir; I mean by adding thirty thousand dollars for each of ten years for operating expense, you can decrease the operating expenses by just that amount during those ten years; where is the unfairness to the stockholders in doing that?—A. What is the use of taking the risk?

Mr. UNTERMYER. What about the interest on the investment? Mr. Denison assumes his proposition and seems to forget that all the time.

By Mr. DENISON:

Q. Then take thirty thousand dollars a year, and the interest on \$300,000, which I suppose is \$1,500, and make it thirty-one thousand dollars in round figures?—A. I can not see why anybody should swap gold dollars. That is all it amounts to. There is no use in stockholders taking the risk of the additional investment and still put themselves in the same position they were before so far as income is concerned.

Q. Is not that saying that changes should not be made at all? It comes out of the stockholders in some way. We have to assume here that the directors were not wasting the funds of the corporation in making this change, and that it was made, as has been testified here, for the purpose of decreasing the operating expenses, and that it has had that effect, and that that effect was predicted on good authority—that it would decrease the operating expenses by fifty per cent on train movement?—A. On the purpose of taking care of the additional capital invested, as well as the original capital.

Q. Very well, if you insist upon putting it that way, but I say this: If you find or if the directors find that by taking thirty thousand dollars of operating expenses each year and putting it into a fund, they can create improvements by the use of that money which will save, say, sixty thousand dollars a year in operating expenses, where is the injustice to the stockholders from the point of view of their income?

Mr. UNTERMYER. But it is forty-nine thousand dollars; it is thirty thousand dollars plus nineteen thousand dollars.

The WITNESS. Thirty thousand dollars will do for the illustration.

The thing to do is this: It is a false statement of expenses. If, after they have their income, you state your expenses correctly and they have an income and choose to set aside \$30,000 or \$50,000 or \$100,000 for future betterments or current betterments, that is their lookout.

By Mr. DENISON:

Q. But you put it on the ground of unfairness to the stockholders on the theory that it would reduce their income. If the fact is that it does not reduce their income in the net result, but ultimately greatly increases it, there would be no unfairness to the stockholders, would there, if that be the fact?—A. If that was the fact, certainly not.

Mr. DENISON. That is all.

By MR. NEEDHAM:

Q. In the case of reduction of the property account by the abandonment of a piece of road not thereafter used, to what account would you charge that?—A. I would charge that to profit and loss.

Q. If there was an abandonment of, say, twenty-five miles of road that had cost \$30,000 per mile, which was contained in the property account—A. (Interrupting.) For which there was no future traffic?

Q. Yes; that would be \$750,000 which you would take out of property account and charge to the profit and loss account?—A. Yes, sir.

Q. If the profit and loss account had credit, it would be reduced that much?—A. Yes, sir.

Q. If profit and loss would show a debit, it would be swelled that much?—A. Yes, sir.

Q. In either case, that would be paid out of earnings, would it?—A. No, sir.

Q. How could profit and loss account become accumulated?—A. It does accumulate out of surplus.

Q. Does it accumulate in any other way than out of earnings?—A. No. There are one or two instances where it does.

Q. Give us those instances?—A. For instance, where a certain piece of property has the title in the road or in the corporation, but part of the cost is paid for by somebody else, the total cost of that property goes into the property account and part of it is credited to the cash account for this expenditure, and the balance to profit and loss is expenditure to outsiders.

Q. These instances of making money that way do not occur very often?—A. No; but we have those in the industrial spurs, for instance.

Q. Speaking generally of the profit and loss account, it is made out of surplus earnings, is it not?—A. Yes, sir.

Q. In the case of the abandoned line, not reproduced in kind, you think it perfectly proper that the profit and loss account representing the earnings should—A. (Interrupting.) Regardless of what the profit and loss account is, it is a distinct loss to the property owners and has to be written off.

Q. And you do not think that is any fraud upon the owners of the property?—A. No, sir.

Q. You would not think it was any fraud—A. (Interrupting.) That does not interfere with a proper statement of their income account currently.

Q. You would not think it was any fraud upon the public for the profit and loss account to be debited instead of credited, to add \$750,000 to that debit and allow them to earn on rates that would pay off that debit in the profit and loss account?—A. The question of rates and the basis of rate making are hardly an accounting question.

Q. It would be a perfectly proper thing to do, would it not? That is, it would not be a fraud upon anybody to allow them to do that?—A. The rates you carry have nothing whatever to do with the condition of your profit and loss account.

Q. I know that rates are not made upon the needs of the company.—A. And your profit and loss account is not added to your property account when there happens to be a debit.

Q. You said you thought it would be a fraud upon the people interested in the earnings of the company?—A. Yes, sir.

Q. To allow them to—A. (Interrupting.) To misstate the situation.

Q. (Continuing.) Pay them for something that was not properly chargeable to the account, but you think it would be no fraud upon them to allow them to earn profits, to pay the debit that I have referred to in the profit and loss account, do you?—A. The rates have nothing whatever to do with that.

Q. I am not speaking of fixing the rates. I am speaking of the right to earn the money to pay off that debt.—A. The corporation has the right to charge the legal charges for its services, and cannot charge anything else, and the question of whether they will not or will earn something to pay off some deficit does not enter into that, and the whole thing is not an accounting question, and that is all I feel as though I could talk about.

Q. I wish you would not talk about rate making, because I am not discussing that at all. What I am discussing is that I am calling your attention to your statement that it was fraudulent to make certain charges, and whether the company has the right to earn money to build up a profit and loss account for the purpose of paying for abandoned property of this kind, of the kind I have spoken of, that is not reproduced in kind?—A. They have a right to collect for their services, regardless of what they do with it.

Q. I did not ask anything about collecting for their services. I am trying to get at the reason for the proposition which you made as to whether or not they have a right to earn money for the purpose of meeting just expenses of this kind and paying for abandoned property?

MR. UNTERMYER. Whether they have the right to earn money?

THE WITNESS. I do not quite understand it. Let me get that again. Have they a right to earn money to pay for abandoned property?

By MR. NEEDHAM:

Q. Yes. A. They have not—straight abandoned property.

Q. Then, on what theory do you say that in this case \$750,000 should be charged to profit and loss account?—A. I do not think I said that. \$750,000 has not been brought up with me.

Q. I call your attention to the abandonment of twenty-five miles of road, not thereafter used for any purpose.—A. Yes.

Q. That it cost thirty thousand dollars a mile and was charged into the property account of that road?—A. Yes.

Q. I understood you to say you would charge that \$750,000 to profit and loss?—A. Yes, sir.

Q. Then, if the profit and loss account was a credit, you would reduce the profit and loss account that much; would you not?—A. Yes.

Q. If it was a debit and you increased the debit \$750,000, would not you think it was perfectly honorable and right for the company to earn money to pay that off?—A. Yes. The trouble is this—

Q. (Interrupting.) Then it is right to earn money for the purpose of paying for abandoned property?—A. Yes; you can—

Q. (Interrupting.) In the case of property which is abandoned and reproduced in kind—and by that I mean reestablishing the line

between the same points and serving the same territory, as is claimed in this case—then, why is it any more a subject of criticism to pay for that abandoned property than to pay for abandoned property in the other case where it is not reproduced in kind?—A. You are talking about two different things.

Q. Surely.—A. Possibly it may be through a mis-understanding of the profit and loss account.

You write down your property account, and that naturally reduces or changes your profit and loss account. It is the occasion of just crossing off so much value that reduces it, although we go through a form, and say, "Charge profit and loss and credit property account." That is one thing.

Q. That is, in the case where the property—

MR. UXTERMAYER (interrupting). May the witness be allowed to answer the question?

MR. NEEDHAM. Yes; I will allow him to answer as fully as he wants to.

THE WITNESS. In this other case, the question is whether you charge expenses of this other property, which, as a necessity, on account of your growth, you have to abandon the use of, and whether in doing that and leaving that in your property account, you are hurting anybody. You are not raising rates. You are putting yourself so you can give better service, and at the same time you are warranted in making the additional expenditure, because the increased efficiency enables you to pay the return on both amounts, the original amount and the additional amount. I simply say that that charge for this property abandoned is not a legitimate charge against expense, which represents simply the cost of producing revenue. You have to find that point for the benefit of all sorts of people that are interested in the enterprise, and any charge which goes in there and destroys the correctness of your net results from operation is to that extent—and especially if it is unknown and unappreciated—a deception to somebody, even to the public.

By MR. NEEDHAM:

Q. It would not be unknown if it were stated in your accounts, would it?—A. Yes, sir.

Q. In your report?—A. Yes, sir. It is wonderful how little the people know about what is in a public document.

Q. It would be as well known as any other fact stated in your report?—A. That is right.

Q. Let us assume the case of a railroad company anticipating the necessity of making changes in its grades so as to reduce the grades, or taking out curves: would you say it was improper for that company to set aside for ten years, out of its earnings, a certain amount to meet that expenditure, and postpone the meeting of that expenditure to the end of ten years?—A. Will you change one word in that question?

Q. I presume I will. I do not know what the word is.—A. Say "surplus," instead of "earnings." You said, "set aside part of the earnings." Use the word "surplus," instead of "earnings." There is a confusion in there.

Q. But I want it out of earnings. Perhaps it has not any surplus.—A. Then it is not surplus.

Q. Let me put the question in another form. Perhaps that will make it better. Here is a railroad company that expects to have to make an expenditure of six hundred thousand dollars to straighten out its curves or to reduce its grades, and the company passes a resolution that for ten years they will set aside sixty thousand dollars a year to meet that expense, and that at the end of that time they will make the change; and that amount is set aside out of the earnings of the company; would you regard that as improper?—A. It never is set aside out of the earnings. It is set aside out of the assets—the current assets.

Q. What do you mean by that—surplus?—A. Yes, sir.

Q. And you stated a few moments ago the surplus was created out of the earnings?—A. But you are putting that so that if I answered it in that way, as you want it, you would immediately claim that was a charge against revenues, ahead of—

Q. (interrupting). Answer it in your own way.—A. If they have a surplus after they have paid all their fixed charges and expenses, arising from their revenue, they can do with it what they please. They can set aside part of it. But if you go to work and deliberately swell their expense by charging that contemplated work to expenses, that would be setting up what the commission and everybody else dislikes very much, and that is a secret reserve. If you will drop the word "earnings" I can answer you in a good many fewer words. I grant that surplus comes eventually from earnings, but we have a different idea when we speak of earnings and surplus.

Q. Let us get at it in this way: Here we have a railroad company that has no surplus, but is able to determine that from the present time on for ten years it will set aside sixty thousand dollars a year to meet a given improvement, which will cost at the end of ten years the estimated amount of \$600,000. Would you regard that as an improper thing to do?—A. I would regard it as an impossible thing to do. They can not set aside something they have not got.

Q. Do you want to leave it right there?—A. Right there; yes.

Q. All right. If they could provide for that ahead, as you have suggested, out of surplus for ten years, and surplus comes from or is created by the earnings, what is the difference so far as the quality of the transaction is concerned between accumulating the money in the surplus account before the improvement is made and making the improvement and charging it to a suspended account, and charging into the operating expenses a certain portion of it, say sixty thousand dollars a year for ten years?—A. The thing about it is that they accumulate, as you say, sixty thousand dollars a year for ten years. They actually own that cash. They change that cash from the treasury to this additional road or new road or equivalent, or whatever it may be. That is one transaction. They have changed a current asset to a fixed asset or investment.

They want, instead of waiting for ten years, to put that in right away. Where will they get the six hundred thousand dollars? They have not got it.

Q. We are talking now about the quality of the transaction and not how they will do it.—A. You can not talk of the quality of a transaction that can not transpire.

Q. If you were sure that the company was to earn sufficient money in the next ten years to set aside or pay out of its earnings sixty



thousand dollars a year for such an improvement as I have suggested, do you think there is anything wrong in that transaction?—A. We are doing that same thing right to-day with lots of roads buying equipment on the installment plan. The only trouble is we do not charge it to expense. We charge that monthly payment or semi-annual payment against our surplus. It is a payment out of surplus and not an expense of something.

Q. Is not the result of that reasoning of yours that the charge should be made to surplus and not to property account?—A. No; because we do not charge surplus. It is in our surplus already and we transfer it from cash to the equivalent as we make the payments.

By Mr. USTERMYER:

Q. You simply change the character of the asset?—A. You change the asset from one pocket to another. That is all.

Mr. NEEDHAM. That is all.

Redirect examination by Mr. USTERMYER:

Q. There is, is there not, Mr. Hudson, a vast difference between compelling a company to charge as part of its operating expenses an improvement, and the company taking out of its earnings, when ascertained, a given sum to apply to that improvement?—A. Yes, sir.

Q. That is the distinction, is it not?—A. Yes, sir.

Q. One is the converting of an improvement or capital asset into an operating expense and the other is simply making an investment part of a realized profit?—A. Yes, sir.

Q. Mr. Denison asked you a hypothetical question somewhat after the following lines: He said if an improvement such as this grade reduction is going to cost \$386,000, and you put aside thirty thousand dollars a year and the interest on the money you borrow for that improvement, which would be nineteen thousand dollars a year on \$386,000, making forty-nine thousand dollars a year, is there any unfairness in charging off that forty-nine thousand dollars a year over a series of years, provided the improvement results in an added profit of \$29,000?

Is it not a fact that when the stockholders of the company make an investment of that kind in an improvement, they take the chance of loss as well as general profits, and is the unfairness of such a transaction in any way minimized by the fact that it happens to turn out that they got their money back? That does not affect the unfairness of it, does it?—A. They do not get their money back.

Q. But assume that they did, it would still be unfair?—A. But there is no provision to pay the money back.

Q. I understand; but his proposition is that in as much as these improvements are going to reduce the cost of operation and increase the facilities of the company—A. (Interrupting.) Increase the net.

Q. Increase the net, yes—that therefore there ought to be no harm in charging it off over a series of years. What have you to say to that proposition?—A. It depends upon who pays for it.

Q. If it is charged against operating expenses it is an enforced payment by the stockholders, is it not?—A. The stockholders pay for it.



Q. And that is a fraud on them, is it not?—A. Certainly it is.

By Mr. NEEDHAM:

Q. Don't they pay for it if it is paid out of profit and loss?—A. Surely.

By Mr. DENISON:

Q. Don't they pay for it if it is paid out of bonds bearing interest?—A. They do.

By Mr. UNTERMYER:

Q. But they get an asset in one case.—A. The only thing in that case is that they are taking in additional partners and have to divide up.

Q. If it is an asset, then they have property to show for the money paid.—A. They have a property expenditure to show.

Q. They have a capital expenditure to show for the money they have spent?—A. Yes, sir.

Q. If, on the other hand, they have charged it to operating expenses and still pay for it, then they have nothing to show for it?—A. No.

By Mr. DENISON:

Q. Does it make any difference in the actual value of their property whether it is written down as capital account or charged to operating expenses?—A. You said value, did you not?

Q. Yes.—A. The question we are discussing is property costs and not value. You can write off your property and write it up, but you do not change the value.

Mr. DENISON. Of course not. That is all.

Witness excused.

Thereupon, after conference with the court and at 4:40 o'clock p. m., the hearing was adjourned until Monday, May 20, 1912, at 10:30 a. m.

WASHINGTON, D. C.,

*Tuesday, December 10, 1912—10:30 o'clock a. m.,*

Present: Mr. Justice Carland.

Appearances: Mr. Arthur M. Wickwire, for the petitioner; Mr. Winfred T. Denison, Assistant Attorney General, and Mr. Thurlow X. Gordon, special assistant to the Attorney General, for the United States of America, respondent; Mr. Charles W. Needham, for the Interstate Commerce Commission, intervening respondent.

#### PROCEEDINGS.

Mr. WICKWIRE. May it please the court, is the hearing open for this case, the Kansas City Southern?

The COURT. Yes.

Mr. WICKWIRE. I will call Mr. Johnston to take the stand.

Mr. NEEDHAM. They are not quite through with their side of the case, if your honor please, they inform me, and they will go on with their side before we put in any testimony.

CHARLES E. JOHNSTON, a witness called on behalf of the petitioner, being first duly sworn, testified as follows:

Direct examination by Mr. Wickwire:

Q. Will you please state your full name?—A. Charles Eugene Johnston.

Q. Where do you reside?—A. Kansas City, Missouri.

Q. What is your occupation?—A. Civil engineer.

Q. Are you employed by the Kansas City Southern Railway Company?—A. Yes, sir.

Q. In what capacity?—A. As chief engineer.

Q. How long have you occupied that position?—A. Almost two years.

Q. Will you state what your experience as an engineer has been?—A. My practical experience has been about fifteen years. I was with the Cotton Belt Railroad in 1897 and 1898; with the Chicago & Eastern Illinois in 1899; with the St. Louis & San Francisco Railroad from January, 1900, until February, 1903; with the Missouri Pacific from February until June, 1903, and then with the St. Louis & San Francisco again from June, 1903, until October, 1906, when I came to the Kansas City Southern, and have been there since.

Q. Will you state in what capacity you have been engaged with these various railroads?—A. With the Cotton Belt I held a minor position in the engineering department, such as chairman and rodman on location and construction; on the Chicago & Eastern Illinois I was on location and construction as instrument man; with the Frisco I was on location and construction as a levelman and a transit man and an assistant engineer; I was also on maintenance of way on the Frisco and as an assistant engineer in charge of general maintenance work; on the Missouri Pacific I was assistant locating engineer and division engineer of construction; on the Kansas City Southern I came to the road as a locating engineer under Mr. H. G. Burt, and followed the location and construction work in the field until January, 1911, when I came in as chief engineer.

Q. You were engaged by the Kansas City Southern during the time of Mr. Burt's examination?—A. Yes, sir.

Q. Did you assist him in that work?—A. I did.

Q. You were engaged with him during the entire time of his examination?—A. Yes, sir; I can say that I was. However, I came there only two or three months after he started the examination. I was there until he finished.

Q. Did you assist him in the preparation of his report?—A. Yes, sir; in several different ways.

Q. Were you familiar with the entire subject of the investigation that he made?—A. Very much so, I think.

Q. I call your attention to Mr. Burt's report which has been offered in evidence, and I will ask you whether you coincide in your views with the recommendations which were made by Mr. Burt in that report.—A. Yes, sir.

Q. I call your attention particularly to that portion of Mr. Burt's report which is set forth in the record in this case at pages 38 to 40, inclusive. Are you familiar with that portion of his report?—A. I have read this part of the record and agree with it.

Q. That coincides with your views?—A. Yes, sir.

Q. You think the principles therein stated are correct?—A. I do.

Q. When the Kansas City Southern determined to make the improvements upon its railroad pursuant to Mr. Burt's report, did you have charge of the work?—A. In what capacity: I do not quite understand you?

Q. What did you have to do? Did you have the function of assisting in the performance of the work?—A. Yes, sir. I had this part to do. I had the locating party and was assigned certain sections of line to investigate and to work out the most economical manner of reducing grades for the increased trainloads we were striving for.

Q. Have you been familiar with the work of grade improvements since it was inaugurated by the road?—A. Yes, sir. Practically my entire time since being with the road has been devoted to that work.

Q. Were there two methods which were presented in which the reduction of the grades might be effected?—A. There were probably more than that.

Q. There were at least two?—A. There were at least two.

Q. State what those methods were.—A. The methods of doing the work, you have reference to?

Q. Yes. I mean with respect to whether it was on or off the line.—A. The methods were whether or not we could reduce the grades on the old right of way or whether it was more economical to change the alignment and find ground better adapted for a lower grade line.

Q. Would it have been physically possible to have effected the revision of grades involved in this case upon the original right of way?—A. No, sir.

Q. You think it would have been very difficult to have effected some of those revisions?—A. It would have been very difficult and expensive.

Q. You do not mean it would have been impossible, do you?—A. No, sir.

Q. Was an estimate made as to the relative cost of effecting the grade revisions by these two methods?—A. The estimates were always made on that basis.

Q. What was the estimated cost of making the six reductions of grade at the six points involved in this case upon the original right of way?—A. I think it was something like \$1,200,000. I have not the exact figures in my mind. The details are in my papers.

Q. What was the approximate estimate of the cost of making these grade reductions by a relocation of a portion of the line?—A. The estimates at that time were about one-half, \$600,000; in that neighborhood.

Q. In respect of the six sections of the line involved in this case it was determined to make these grade reductions by the less expensive method, was it not?—A. Yes, sir.

Q. That is, by a relocation of a portion of the track?—A. By changing the line. It was considered good practice.

Q. Have you a map which shows the six locations and sets forth the grades and changes which were made?—A. Yes, sir; I have a map of the entire line showing the general grade-reduction plan, which includes the six referred to.

Mr. NEEDHAM. This includes more than is in controversy here?

Mr. WICKWIRE. Yes, sir. I would like to have this marked "Petitioner's Exhibit No. 9."

The map referred to was marked "Petitioner's Exhibit No. 9."

Mr. NEEDHAM. If you will have it indicated just what part of this map applies to the matters in controversy in this suit, I have no objection to that.

Mr. WICKWIRE. I am going to do that.

Mr. NEEDHAM. I want to reserve an objection as to the part of it that covers the line not in controversy.

Mr. WICKWIRE. I will ask him some questions before offering it, if your honor please.

By Mr. WICKWIRE:

Q. Does this map represent the profile or topography of this road as it was located prior to the time of the improvements in question?—A. Yes, sir; it represents—part of the map is a condensed profile of the old line as well as of the new.

Q. This map covers the road between what points?—A. Between Kansas City and Port Arthur and the Fort Smith and Lake Charles branches.

Q. The upper half of this map represents what?—A. That is a condensed profile.

Q. And the lower half of the map represents what?—A. It is a general alignment map.

Q. The upper half is divided into rectangles with certain figures along at the foot and along on the side. Will you please explain what these figures represent?—A. I suppose you refer to the scale of the map?

Q. Yes.—A. The horizontal scale is one inch equals twenty miles, and the vertical scale one inch equals four hundred feet.

Q. Upon the foot of this plat, on the upper half of the map, are figures marked "10, 20, 30," and so forth.—A. Those are mileage figures.

Q. The figures along the side of this chart running from zero up to seventeen hundred represent what?—A. Those are the elevation figures, above sea level.

Q. And seventeen hundred represents feet?—A. Feet; yes, sir; feet above sea level.

Q. At Port Arthur the road is substantially at sea level?—A. Yes, sir; only slightly above.

Q. At Kansas City the elevation is how much?—A. It is approximately seven hundred and fifty feet.

Q. The highest point or peak upon this line of railroad is located where?—A. At Rich Mountain, Arkansas.

Q. That is about half way between Port Arthur and Kansas City?—A. It is not quite; it is 368 miles south of Kansas City.

Q. That is how high?—A. 1,625 feet.

Q. Will you state where the six locations or portions of railroad involved in this case are located with respect to this profile? A. Five of the six referred to are located between Stilwell and Heavener, Oklahoma, a total distance of 79.7 miles, shown in red on the print. The other one is located on the engine district between Leesville and

MAPS

TOO

LARGE

FOR

FILMING



Port Arthur, or near the station of Pickering, Louisiana, and also shown in red on the print.

Q. Along the line of the railroad as represented upon this profile there are certain markings in red and some in yellow. Will you please explain what those represent?—A. The red indicates changes in alignment off the old right of way, and the yellow indicates revisions approximately on the present way.

Mr. WICKWIRE (showing the map marked "Petitioner's Exhibit No. 9" to the court): I do not know whether your honor has been able to follow the testimony without this map.

Mr. NEEDHAM. I withdraw my objections to the map.

By Mr. WICKWIRE:

Q. For instance, Mr. Johnston, referring to this triangle in red, as I understand it, the upper point of the triangle represents the elevation of the road as it stood prior to the time these improvements were inaugurated?—A. Yes, sir; it is the old line.

Q. And the base of the triangle represents the present grade of the road upon the new location?—A. Yes, sir; it is the new grade superimposed on the old grade.

Q. And these figures here (indicating) represent in all cases, do they not, the grade of the old line and the new grade?—A. Yes, sir.

Q. Which has been effected?—A. Yes, sir.

Q. That is true also with respect to the figures set opposite these segments marked in yellow?—A. Yes, sir.

Q. Calling attention to this particular one as an illustration, in yellow, will you state what the old grade was and what the new grade is?—A. The old grade in that case is one per cent. It is a place where a raise is made in the old grade. We raised it up in order to get this, and in that case the new grade is shown above. It is a raise of grade in the old line, raised and filled across the bottom. In the new grade five-tenths is shown above and the old grade is shown below.

Q. With reference to the chart on the bottom of this map, state what the portions in red and what the portions in yellow represent.—A. The portions in red indicate the new lines where we have de-toured away from the old, and the portions in yellow indicate the limits of revision on the old line.

Q. Will you please explain to the court why the expense would be greater to do the work upon the old locations than to do the work upon the new locations in the six sections involved in this case?—A. On account of the particular location of the old line a reduced grade would make the grading excessive above the new line, just a matter of estimate of grading quantities, and also the handling of traffic. We have found in doing new work that the handling of traffic during reconstruction is a very expensive procedure.

Q. Did the actual cost of doing this work overrun the estimated expenditure?—A. Yes, sir.

Q. Have you the figures showing the actual expenditure upon these six portions of the line?—A. Yes, sir; as of October 31, 1912.

Q. Will you please state what it was?—A. \$767,159, not including the value of the old material used, which was \$91,685.

Q. I call your attention to Exhibit A annexed to the petition, and will ask you to state whether that represents the estimated expendi-

ture of doing the work upon these six sections of the road under the two methods.—A. Yes, sir; it is an estimate of cost to reduce the old line in its present location, and also an estimate of cost in constructing the new line.

Q. Were those estimates substantially accurate?—A. They were made on the best figures available at that time, as to what the work would cost.

Q. Will you state the reason why the actual expense of doing the work overran the estimates?—A. There are many reasons. One reason is that the unit prices for doing work increased during the time elapsed between the time the estimates were made and the time the work was started. This also includes the excessive cost of right of way, the land becoming more improved and consequently the price going up. Furthermore, the classification in the grading exceeded the estimate, for the reason that classification is an unknown quantity, and in many cases an approximate estimate is the best you can do.

Q. There was some increase in the cost of labor and material, was there not?—A. Yes, sir.

Q. Which accounted to some extent—A. (Interrupting.) That was the increase in prices I referred to.

Q. Had these grade reductions been made upon the original right of way at these six points, would the actual cost thereof have exceeded the estimated cost in the same proportion?—A. I would estimate at this time that they would exceed the original figures on a greater basis or to a greater extent.

Q. On a greater proportion?—A. On a greater proportion; yes, sir.

Mr. WICKWIRE. Exhibit A, annexed to the petition, your honor, has already been offered in evidence at the first hearing.

By Mr. WICKWIRE:

Q. Will you please state what the physical condition of the railroad was—the roadway and the railroad—at the time these changes were made?—A. The physical condition of the particular pieces of line?

Q. Yes; the six particular sections involved in this case.—A. The physical condition of the piece of line in question was up to our standard—as good as any other part of the entire line—and I can say they were in very good condition—in a good state of repair.

Q. The line was not worn out?—A. No, sir.

Q. Or in an obsolete condition?—A. No, sir. We kept the line up as well as we did the balance of the line and it was in very good condition.

Q. Was there any element in reference to these six sections of the line which dictated their abandonment other than the purpose of reducing grade?—A. No, sir; none that I know of.

Q. Will you state what the purpose was of making these grade revisions?—A. The purpose of making the grade revisions and changes of line in question—it was a part of a general plan to increase trainload, and thereby reduce operating expenses and give better service to the public.

Q. Will you state what the result with respect to the matter of economy is of changing the grade of the railroad from a one per cent line to a five-tenths of one per cent line?—A. The result to which I think you refer is that we are able to almost double or double the



trainloads, and thereby move the increased tonnage at approximately the same cost. In other words, the saving in operation in that particular part is about 50 per cent.

Q. What were the grades on this road as originally constructed?

Mr. NEEDHAM. You refer to these particular lines?

Mr. WICKWIRE. No; the whole railroad.

By Mr. WICKWIRE:

Q. What were the maximum grades?—A. The maximum grade on the Kansas City Southern main line over which we operate freight trains is 1.64, uncompensated for curvature.

Q. The general maximum grade was about how much?—A. About one per cent. That was the majority of the ruling grade.

Q. As I understand it, it was the purpose of this plan of grade revision to reduce the grades to a maximum of five-tenths of one per cent?—A. Yes, sir; that is the ultimate plan of the road.

Q. It was estimated that that reduction of grade would substantially double the trainload which could be moved over the line?—

A. Yes, sir.

Q. What is the particular difficulty or handicap which grows out of heavy grades?

Mr. NEEDHAM. You mean generally or on this road?

Mr. WICKWIRE. Generally.

The WITNESS. I do not quite understand the question.

By Mr. WICKWIRE:

Q. Will you explain why it is that an addition of five-tenths of one per cent up to a total of one per cent causes such an increase in the cost of moving the freight?—A. You have certain regulations that force you to have full crews; schedules of wages are high; and, what I think you are trying to bring out, it costs the railroad company as much money to move, in labor and to a certain extent power—of course, it takes more power to move a heavier train than a light train.

Q. That is what I mean. I mean about the amount of power required to get up the grades of one per cent. The amount of power required is much greater, is it not?—A. Oh, yes; for handling the same train for one per cent.

Q. For a given trainload?—A. Yes. It takes more power, and at the same time on the one per cent grade you would pay wages as much as you would on a five-tenths of one per cent grade.

Q. When these revisions were made off the line, was the track at these points as efficient as it would have been had the reduction of grades been made upon the original right of way?—A. Yes, sir; there would be no difference.

Q. Will the line of a railroad constructed at a maximum grade of one per cent coincide with the survey of a railroad having a maximum of one-half of one per cent?—A. No, sir; it is not practicable to locate a five-tenths per cent line on a one per cent location.

Q. If a survey is made for the purpose of locating a railroad having a five-tenths per cent grade, different supporting ground is chosen from what would be chosen for a one per cent maximum grade?—

A. Yes, sir.

Q. You are familiar with the location of this road. Will you state whether in your judgment it was properly located as a one per

cent maximum grade, or approximately that, at the time it was built?—A. Yes, sir; I think the location of the old line of the Kansas City Southern, upon the basis they were working, was done exceedingly well. In fact, we found but very few instances where we could have made an improvement under the same basis.

Q. So that the location, in your judgment, was in no way a mistake?—A. I do not think so.

Q. Is it the history of railroad construction in this country that lines have to be improved from time to time to meet the increased demands made upon them?—A. Yes, sir.

Q. Due to what factors?—A. The development of the country, the increase in traffic, and a number of others that enter into it that are almost as important—something you can not foretell when you build a line.

Q. In the ordinary case of railroad construction would it pay to construct a railroad upon a five-tenths per cent grade?—A. It would not on the Kansas City Southern. It would not have paid, because at that time the business barely justified the one per cent grade; probably did not.

Q. What have you to say with respect to the construction of the original road with reference to its being a temporary structure?

Mr. NEEDHAM. I object to that. He was not with the Kansas City Southern at that time. He has no personal knowledge of what led to the construction of it at that time, whether it was temporary or permanent. Of course, it was permanent. It would not have been built in the way it was built if it had not been a permanent location.

I assume from the question that it is expected to draw forth an answer that this was in a sense a temporary location. I do not think that can be shown by a witness who has recently come to the road.

Mr. WICKWIRE. I will change the form of the question.

By Mr. WICKWIRE:

Q. Will you please state what the situation is with respect to railroads built generally through a sparsely settled country?—A. The general practice of building roads through a country like you mention, or a country, as a comparison, similar to the country that the Kansas City Southern traversed at that time, is that a road is built as cheaply as possible, as I say, in a temporary manner, for the reason that nothing is known of the development—of what the development will be. In our case we found oil and we found coal, and it has developed into a great fruit country; they had no idea at that time of the density of traffic. No doubt when the engineers located and built the line, and the people who were behind it in a number of cases, if they could have seen the country would develop like it has in the East, or in Illinois and Indiana, would have made changes in the grade, and these grade objections would have been removed to a great extent.

Q. Has that in general been the history of railroading in this country?—A. It has; yes, sir.

Q. Then, as I understand it, you consider a railroad originally built in sparsely settled country in the nature of a stage in the development of the finally completed railroad?—A. I do.

Q. In more permanent form?—A. I do. The work has to be done to an ultimate permanent plan for the future regardless of where the work is, not only in grades, but everything else; and as business develops a change will have to be made to take care of it.

Q. Will you state whether the changes in grade involved in this case were in the nature of a permanent improvement of the property?

Mr. NEEDHAM. I reserve an objection to that if your honor please. I do not care to present it just now, but I would like to reserve an objection to that question.

The COURT. Yes.

The WITNESS. Will you state your question again?

Mr. WICKWIRE. Please read the question.

The question was read by the reporter, as follows:

Will you state whether the changes in grade involved in this case were in the nature of a permanent improvement of the property?

A. The changes in grade made are in most cases considered of a permanent nature. However, the development of the country may at some future time require further adjustment.

Q. Is it your view that this was an improvement of the property?—A. Very much of an improvement.

Q. Were estimates made as to whether the road would maintain its present earnings and would also yield something additional in net return by reason of these improvements?—A. Yes, sir.

Q. What was the result arrived at, the conclusion reached on that point?—A. The conclusions were that certain changes would bring about a reduced cost in operation to justify the expense on the basis of the business moving at that time, and that a further increase in traffic would mean a still greater reduction.

Q. Was it your opinion at that time that these improvements were justified by the then state of the company's traffic?—A. Yes, sir.

Q. And that there would be an improvement in the immediate future in the net returns?—A. Yes, sir.

Q. State whether or not that improvement would be proportionately greater if the business of the road in the future should increase.—A. It would, for the reason you have certain fixed expenses whether you do a large business or a small business. You can many times do an increased business with the factor remaining the same, and your benefits or net earnings are greater in, you might say, geometrical proportion.

Q. State your opinion as to whether the changes made upon these six points on the line enhanced the value of the entire railroad to an amount equal to the cost of those improvements.—A. Yes, sir; in my opinion. And from the actual operation which will indicate that our earning power is greater it does enhance the value of the entire line.

Q. To an amount at least equal to the expense?—A. To an amount at least equal to the expense.

Q. In addition to the six portions of the road as to which you have been questioned, the company determined to make some changes at Liverpool, Louisiana?—A. In shop facilities; yes, sir.

Q. Will you state what the company determined to do there?—A. It was determined to increase our facilities of all kinds as a terminal and shop layout, in order that we could better handle our

business and handle an increased business on a more economical basis.

Q. The company had a shop at Shreveport at that time?—A. Yes, sir.

Q. What was the condition of that shop?—A. The old shop at Shreveport, the one that was abandoned there for the new facilities was in a good state of repair, and it was kept that way in order to handle our business.

Q. Was it obsolete?—A. I can not say it was obsolete; no, sir. It was not obsolete; it was just inadequate to handle the business.

Q. The increased business you mean?—A. The increased as well as the present, because we were cramped as it was.

Q. State whether or not it was capable, with ordinary running repairs, of performing the functions for which it was originally constructed.—A. Yes, sir; it undoubtedly was.

Q. For an indefinite period?—A. It did and it would for an indefinite period.

Q. Did the company construct a new shop and terminal facilities at Shreveport?—A. Yes, sir.

Q. Did it then discontinue the use of the former shop?—A. Yes, sir.

Q. That was dismantled?—A. Yes, sir. It was necessary to dismantle it in order to get the new shops in.

Q. The estimated value of the Shreveport shop, less salvage, was about \$100,000?—A. About \$100,000; yes, sir.

Q. Are the improvements at that point complete?—A. The shop improvements you refer to?

Q. Yes.—A. Practically so; yes, sir; there is a little work to do.

Q. Have you the figures showing the expense of the construction of the new shops?—A. I do not believe I have the exact figures as of the present time, but it is about \$600,000 at this time.

Q. Will you state whether or not in your opinion the value of the railroad property has been increased to an amount equal to the amount of this expenditure?—A. Yes, sir; that is my opinion.

Q. Has the improvement resulted in increased efficiency?—A. Yes, sir; very much so.

Q. In the reduction of expenses?—A. Yes, sir.

Q. In addition to the work which has been done upon the six portions of the railroad involved in the petition, has the company done any improvement along its railroad involving any other changes of alignment?—A. Yes, sir.

Q. About how many instances of improvement of that kind has the company made in addition to those set forth in the petition?—A. You refer to line changes?

Q. Line changes for the purpose of grade reductions.—A. I understand. There are something like fifteen more.

Q. During the time that these improvements have been made by changes through relocations the railroad has also been making various improvements upon the original roadway, has it not, in the way of change of grade?—A. We probably have spent as much money revising grades on our old line as we have in changing the line.

Q. Do you know approximately how much the railroad company has spent up to this time in all of its grade reductions from the time

this program was inaugurated?—A. It would be an approximate figure. I think the approximate figure is about \$4,000,000.

Q. This work is now going forward?—A. Yes, sir; we are just closing out an engine district—the work on an engine district.

Q. The improvements which were made at these six sections of the line have resulted, as I understand it, in increasing the capacity of the road as well as in reducing the expenses of train movement?—

A. The capacity to handle their business?

Q. Yes.—A. Yes, sir.

Q. If the volume of the business should have increased while the old line was in operation to a point where it would become impracticable to handle so much freight, the company could have accommodated itself to that condition either by lowering the grades or by building a second track, could it not?—A. Yes, sir.

Q. Does the lowering of the grade of the railroad from a maximum of one per cent or upwards to one-half of one per cent substantially double the volume of traffic which can be handled over the line?—A. I think so.

Q. And if the volume of traffic upon the old line had reached the limit of what the line could handle, the additional traffic could have been handled either by double-tracking the road or by lowering the grade? That is your position, is it?—A. Yes, sir; those would be two ways of handling it.

Mr. WICKWIRE. You may cross-examine.

Cross-examination:

Mr. DENISON. Mr. Denison has no cross-examination.

By Mr. NEEDHAM:

Q. What do you mean by the statement that the capacity of the road is doubled by double-tracking it?—A. I means this, that the power you have on the line in handling traffic about doubles the traffic, with the lower grade, as between the two grades.

Q. But I understood you to say in reply to a question that there were two ways to increase the capacity of the road—one by lowering the grades and the other by double-tracking the road.—A. I said those are two ways. I did not say there were two ways. There are several ways.

Q. In your judgment would it double the capacity of the road to handle the traffic by double-tracking the road?—A. Will you repeat that question, please?

The pending question was repeated by the reporter, as above recorded.

A. I think the conditions are a factor in the double-tracking, the average grades to take care of, grades to contend with on double-track railroads. It probably would not double it in many cases, but probably in many cases it would more than double it.

Q. It would not increase the size of the trains?—A. No, sir.

Q. (Continuing.) Carried by the same locomotive and same crew?—A. No, sir.

Q. The only advantages would arise from the handling of the traffic both ways?—A. Yes, sir.

Q. By the use of two tracks instead of one?—A. Yes, sir; reducing congestion.

Q. That is the only way that double-tracking would increase the traffic?—A. That is an important factor in certain territories, where the cost of double-tracking is low.

Q. But I am asking you now with reference to the increase of the volume of the traffic.—A. As between the handling of the volume of the traffic?

Q. As between a single track and a double track.—A. It is a fact you can handle a greater volume of traffic on a double-track railroad than you can on a single-track railroad.

Q. The amount of the difference depends on whether the traffic is all one way or is equally distributed?—A. That has a great deal to do with it. There are other conditions entering into it. You can not say it doubles it, because it may not, or it may go more than that.

Q. You say that reducing this grade to one-half of one per cent would double the efficiency of the road. What I wanted to ask you was whether or not, in your opinion, double-tracking the road would produce the same efficiency?—A. I do not hardly believe it would on these particular divisions or districts. I do not think it would because the traffic there would not probably be so heavy as to bring about an increased efficiency by double-tracking as much as it would by a change in grades.

Q. You gave as your reason for lowering the grades that the same power and the same crew could handle a much larger train. Is that correct?—A. Yes, sir.

Q. That would not be true or have that effect by double-tracking the road?—A. No, sir. You mean double-tracking on the same grade?

Q. Certainly.—A. Yes, sir.

Q. Reducing the grade from a one per cent on particular parts of your line to one-half of one per cent would result in an economy over those portions of the line, as you have stated, but that would not effect an economy in handling trainloads on other portions of the line?—A. No, sir.

Q. I notice by the profile which you have presented that the heavy grades are on other portions of the line than those in controversy?—A. Yes, sir.

Q. Have those been changed?—A. No, sir.

Q. Are they to be changed?—A. Ultimately; yes, sir.

Q. Ultimately?—A. That is the ultimate plan; yes, sir. The cost makes it prohibitive at this time.

Q. Take these grades which you say are 1.64 per cent. Where are they?—A. They are not the territory that the particular line changes refer to here.

Q. Will you indicate where they are on this profile?—A. What we call Neosho Hill—this is the grade right here [indicating]. It is at milepost 175 to milepost 178, south of Kansas City.

Q. How do you pass your trainload over that grade if you have increased your efficiency or capacity fifty per cent?—A. That comes on a district that we have not reduced to a five-tenths grade.

Q. I understood you to say that these improvements that you have made have doubled the capacity of the entire road?—A. I did not mean to say that.

Q. What do you say, then, with reference to the effect of these improvements upon these particular portions of the road?—A. I say that, in my opinion, the particular portions of districts revised are in position to handle twice the traffic that we handled over the old lines.

Q. What is the effect of it upon the entire line?—A. The ultimate effect will be over the entire line.

Q. How can the reducing of grades over these portions of the lines affect the handling of traffic over other portions of the lines not improved?—A. It can not, as I can see.

Q. Then what will be the effect of the improvements which you have made upon the parts of the line which are not improved—that is, by a reduction of grade?—A. There will be no effect in the train movements in handling freight over the other parts of the line.

Q. You can not handle any more?—A. No, sir.

Q. (Continuing.) Than before these grade improvements were made?—A. Not over other parts of the line; no, sir.

Q. In selecting these portions of the line, did you have reference to any particular traffic that was to be advantaged?—A. We had this to work from: We had the traffic as of 1906 and 1907. It is covered in Mr. Burt's report. Then we had the increase from year to year up until that time.

Q. Do you mean with reference to the particular portions of the road or with reference to the entire road?—A. We figured each district separately and apart from the others in figuring upon economies and savings, and we knew how much traffic was over that particular piece of line in that year and also the traffic for the year preceding it. Then, of course, in making our figures we took the increase from year to year and arrived at a set of figures—what it would be if the traffic was increased up to one hundred per cent or two hundred per cent.

Q. Take this first section that you have marked here, beginning about 260 miles south of Kansas City.—A. Yes, sir.

Q. Why did you select that particular portion of the road for improvements?—A. The probable reason that was selected—

Q. I did not ask the probable reason.—A. Well, the reason—

Q. You say you were working there at the time; you have called attention to the fact that the heaviest grades are between that point and Kansas City. Why did you select that particular section of road for this grade improvement?—A. Because it could be done at a less cost than other sections. We could realize quicker on the investment.

Q. Did you have any reference to traffic over that particular section?—A. Yes, sir.

Q. Is the traffic over that particular section any different than the traffic coming from Kansas City to this point?—A. I think not.

Q. In volume or kind?—A. I think not. We would have picked that section had it been the same.

Q. Then you did not select that section particularly with reference to the traffic?—A. Yes, sir.

Q. But you have said that increasing the efficiency of that particular portion of the road improved would not help or increase the efficiency of the road at other points. Now, then, how would that increase the traffic?—A. It does not increase the traffic on that particular eighty miles.

Q. Does it increase the traffic on the road?—A. No, sir; it helps to. It tends to increase the traffic of the road.

Q. How?—A. For this reason: That we can handle more promptly and give better service on that particular stretch for our shippers from the south end of Kansas City; we can handle it with more dispatch over that portion, and the same would be true over any other portion.

Q. Are there not heavy grades south?—A. There are; yes, sir.

Q. Heavier than those you changed?—A. Yes, sir.

Q. And all trainloads coming from the south and crossing this particular section have to pass over the higher grades?—A. Yes, sir.

Q. That is not affected at all by this improvement?—A. Not below. I would not say; but you have the same movement south.

Q. What I want to get at, and I want you to explain, is this: That so far as the traffic from the north to the south or from the south to the north is concerned, the volume of the traffic and the expense of handling the traffic over the entire line is only reduced by the reduction of the expense on this particular section; is that right, and on this section to the south also?—A. Will you read that question again?

The pending question was repeated by the reporter, as above recorded.

A. I think so.

Q. Then, doubling the capacity at this point does not necessarily increase the capacity of the entire line?—A. It does to a certain extent.

Q. What do you mean by that?—A. I mean if you can increase or improve your efficiency on one particular district, you affect your operation over the entire line. And you get business therefrom, you handle traffic, say from Shreveport to Kansas City—

Q. You mean you handle more traffic over these high grades by reason of this improvement?—A. You can not by reason of this particular district.

Q. How, by that improvement, have you increased the efficiency of the entire road to handle through traffic either way?—A. By gaining the advantage of the prompt handling; you can say that the increase efficiency of this particular line affects to increase the efficiency of your entire line, in that way of looking at it.

Q. Please explain that.—A. I mean this: People at Shreveport shipping cars of freight to Kansas City, of course, it is competitive business; if we can handle over the old line this business from Shreveport to Kansas City, a carload of merchandise or whatever it might be, in six days, and we can adjust a hundred or two hundred miles that will save a day, that will affect the movement of that freight from Shreveport to Kansas City and enable them to get their freight a half a day, a day, or a day and a half sooner than they would otherwise.

Q. Then it is a question of time?—A. Yes; a question of time.

Q. You can handle it more rapidly over this particular section—approximately 80 miles; that is you can run 80 miles faster than you could if you had not improved the grades?—A. Our movements are faster.



Q. Can you suggest any other advantage to the through traffic?—

A. It does not affect the handling over the old divisions that we have not touched yet. There is no question of that.

Q. You stated that this doubled the capacity or efficiency of the road improved. Assume that with a given power and with a given crew you could handle an ordinary average freight train of, say, 30 cars over the old line. You mean by that that with the same power and the same crew you could handle 60 cars?—A. Yes, sir.

Q. Over the line as improved; is that right?—A. Pull double the tonnage in the same length of time.

Q. And that would increase the efficiency over that part of the road to that extent, but the through freight would have to be gotten to this point in train loads of 30 cars?—A. Yes, sir.

Q. The only advantage then you would get on that 70 miles would be you could double the trains that have come over the line in 30 cars to 60 cars and reduce the cost of the service to that extent. Do you do that?—A. We are handling that on that district right now.

Q. You break the trains here and handle them through in double the number of cars, practically?—A. We break the trains at both sides and handle them through.

Q. How does that increase the traffic where so much of the line still remains at the old grades and requires trains of 30 cars?—

A. This is a part of the general plan, of course. Probably it is only one spoke in the wheel of the general plan. It all helps to improve your railroad and promote efficiency.

Q. You do not mean to say, as you did upon your direct examination, that this improvement over this 70 miles doubles the capacity or efficiency of the entire line?—A. Oh, no.

Mr. WICKWIRE. I do not think he so stated; at least, I did not so understand it.

Mr. NEEDHAM. Well, we have it straight, anyway. I understood him to say that.

By Mr. NEEDHAM:

Q. There is no question that these parts of the line indicated in red have been abandoned?—A. They have been abandoned; yes.

Q. The old line has been abandoned?—A. Yes; and the tracks taken up.

Q. And the new has been established and is now in operation?—A. Yes, sir.

Q. I understood you to say also with reference to the shop that it had been abandoned?—A. Yes, sir.

Q. You stated that in building a new road with a required maximum grade, engineers would locate differently for a one per cent than they would for a half per cent?—A. Yes, sir.

Q. Will you explain that again. I did not quite understand you. Why would they do that?—A. They would do it for the reason that a one per cent grade line requires different supporting ground than a five-tenths grade.

Q. What do you mean by different supporting ground?—A. I mean that the line is so located—for instance, a one per cent grade, when we locate a one per cent grade, we have to find the most economical location for the one per cent grade. You can not use over a maximum of one per cent grade. And your costs enter into it.

When you go out to locate the one per cent grade you hunt the ground to lay the one per cent grade on, and you find it.

When you come to put a five-tenths per cent grade on it, it is not the ground for the five-tenths per cent grade. In other words, your rate of rise and fall is greater, or different, and consequently you strike different ground.

Q. When you say different ground you do not mean different in the substantial quality of the ground as a foundation?—A. Oh, no.

Q. But you mean the contour of the ground?—A. The contour.

Q. That is to say, you might be compelled to go a longer distance?—A. That is it.

Q. To get a five-tenths per cent grade than you would to get a one per cent grade?—A. Yes, sir; and there is a reason for that. The reason is you can not climb with a five-tenths per cent as fast as you can with a one per cent.

Q. I do not quite understand that. —A. You can not overcome as much elevation in a given distance with five-tenths per cent as you can with one per cent, and you have to make your line accordingly, unless you go into heavy work.

Q. You lay it down, then, as a principle that if an engineer is required to lay out a railroad with a maximum of one per cent grade that he will select a different line than he would if he was required to lay out a railroad with one-half of one per cent grade?—A. The topography of the country makes you select a different location as between the two different grades.

Q. What do you mean by "makes you do it"?—A. It forces you to do it, to get the most economical line?

Q. That is to say, if I understand you, if the maximum is one per cent, the aim would be to get a shorter line by using a right of way, the topography of which is not good for a location if the maximum is to be five-tenths per cent; is that right?—A. Yes, sir; that is right to a certain extent.

Q. Is there any other reason?—A. Working on a one per cent line basis allows you to get a shorter line naturally, and that is generally the reason that your one per cent lines are a little shorter than five-tenths per cent lines.

Q. Is there any other reason that occurs to you?—A. There are other reasons. Some reasons are the country is not investigated fully, and an engineer at times goes wrong, as well as anybody else. That is another reason.

Q. That is, they might have found another line that would have been accessible for a one per cent grade that might have been a little shorter than the line they did locate upon?—A. That is it. In a number of cases they locate in timber and heavy underbrush, and can not see the country, but do the best they can. In later years they come along when it is cleared and see where they could better it for a one per cent line.

Q. I understood you to say in your judgment this road was located temporarily with reference to increasing or decreasing the grades ultimately when the traffic required it. —A. I did not say they located temporarily and built it as a temporary structure with a view of changing it. I said I had no doubt but what they had that in mind, that some day somebody would come along and find it necessary to change it, although it would not affect their locations.

Q. Why do you think they had that in mind?—A. I would think the same thing if I were going out in new country and locating a one per cent railroad. I would figure on the later development of the country, and I would figure that some day the traffic in this section of the country would make it necessary to reduce this grade line.

Q. When you say you would figure that way, do you mean to say it would affect your action as an engineer in locating the road, or do you mean that would pass through your mind as a thought?—A. I mean to say it would affect it.

Q. It would affect it?—A. In this manner.

Q. Then tell me why you would not locate it upon ground that could be reduced to a one-half of one per cent grade.—A. You would if you could locate your one per cent upon the ground at the same cost you could locate it on some other ground.

Q. You mean by cost for the same distance of road?—A. It all figures in.

Q. What else figures in?—A. The cost, the rise and fall, the curvature.

Q. If you get a maximum of one per cent grade what other item enters into consideration other than distance?—A. Curvature is one.

Q. Curvature and distance; what else?—A. Rise and fall. There are four principles—the distance you go up and down, the rise and fall of your grade line.

Q. So long as you keep within the maximum one per cent?—A. Not necessarily. You can stay within your maximum of one per cent, and then have a railroad you could hardly operate on unless you used judgment in looking for your rise-and-fall feature.

Q. Then, in locating a one per cent grade do you mean to say that the engineer, locating in that way and having in his mind that the grade would have to be reduced, that he would select a different line than he would if he did not have that in mind?—A. He would not select a different line so long as there was no difference in the first cost of the one per cent line. In other words, if it costs more on the basis of a one per cent line to locate it at a place where it could be reduced at a reasonable cost, or better, be reduced to a five-tenths grade, why he would not put it on that location.

Q. If there were two locations both within the one per cent maximum, and one a possible opportunity to reduce it to one-half of one per cent at a reasonable cost, he would take that line instead of the other?—A. Yes, sir.

Q. That is what you mean?—A. Yes, sir; he would undoubtedly take it in preference to the other. That would be his judgment and he would have to do it. His engineering teaches him that.

Q. That is what you mean by having in view the future relocation of the line?—A. That is it exactly.

Q. So that in your judgment this line was originally located with a view of reducing its grades in the future?—A. In many cases it was; I have found that.

Q. For the reasons which you have given?—A. I have found that, yes, sir. We have done a great deal of reducing on the present location, you know. Probably half of our work has been that way.

Q. Take the first five changes that were made within the red lines last indicated. What were the reasons for changing the line?—A. The reasons were to get a five-tenths grade line.

Q. Tell us just what was there and what occasioned the change of the line.—A. What physical characteristics?

Q. Yes.—A. It was the excessive grading work that would be necessary to reduce it on its present location.

Q. Take this first change that was made. You are familiar with this, as I understand you?—A. Yes, sir.

Q. Opposite Windsor [indicating on map, petitioner's Exhibit No. 9]?—A. That is it.

Q. What were the physical conditions there that made it necessary or desirable to change from the old line as indicated on the upper line of the red and the lower line of the red?—A. To save the cost of grading.

Q. Tell us the physical condition; what was the physical condition there? Was it hilly?—A. There was a high hill there in the center of this line. If you started at the end of the change and carried a five-tenths grade through that hill it would have made the cut—in most cases it is solid rock—very deep and expensive to take out.

Q. Did you go around the hill?—A. We went around the hill; yes, sir.

Q. And increased the distance?—A. I think the distance is practically the same.

Q. Is it as far around a hill as it is through it?—A. In many cases.

Q. How do you explain that to a layman?—A. Your hill may have a swing to it, just the same as your valley. I have found some hill lines longer than your valley lines.

Q. Was that the case there?—A. It is practically the same distance.

Q. Practically the same distance?—A. Yes, sir.

Q. That is to say, the engineer then in locating that road originally put it over the hill where you could not reduce it to a five-tenths per cent grade, instead of putting it around the hill the same distance where it could be reduced to a five-tenths per cent grade?—A. Yes, sir.

Q. And yet you think he had in mind a reduction to a five-tenths per cent grade?—A. The one per cent grade in this particular line change is over the hill, and he laid it very close to the ground, without much work. Coming around the hill he goes into the creek, and he crosses the creek a time or two, which necessitates bridging. He was staying away from his low ground. Following the surface of the ground, if he got it in the bottom, it would have been so low he would have had washouts continually, and he put it up on the hill.

Q. You are giving us some new matter with reference to the physical conditions, and that is what I want to get at. In order to go around the hill you had to put in bridging?—A. Yes, sir.

Q. And it was to avoid the bridging that the original line was laid over the hill?—A. Partly so, and the position of the grade line, the one per cent grade line. They were laying a grade as close to the ground as they could get it, on the one per cent basis, as they worked. If he had laid this one per cent grade line around the hill and in the creek bottoms, his grade would have been so low that he would have had numerous washouts. The bottom overflows, and he kept out of trouble and kept up on hill ground.

Q. Did you raise the track to the north of this improvement?—A. That track to the north of the improvement was—

Q. In here [indicating]?—A. No, sir; that was not raised.

Q. Then you started with exactly the same grade he had to go over the hill?—A. Oh, yes, sir.

Q. And you took the other line and put in bridging?—A. Yes, sir; raised the fill up above the bottom so that washouts and water would not overflow.

Q. The problem with you was precisely the same as the problem with the original engineer, then, if you started the road with the same grade at the beginning of the change?—A. The problem with me was a five-tenths per cent grade and the problem with him was one per cent.

Q. I understand; but I say, so far as locating upon what could be a lower grade than one per cent, the problem was precisely the same?—A. Yes, sir.

Q. You did not raise the track?—A. Oh, no, sir.

Q. You started exactly with the same problem he had as to whether you would go over the hill or whether you would go around it?—A. At a common point at each end of the change. We started and stopped at a common point, of course.

Q. Is that practically true of all these five changes that were made in here?—A. Yes, sir; you might say it is.

Q. That is a fair illustration?—A. That is a fair illustration.

Q. Of the change that was made and the reasons for it?—A. I do not know that you are clear on the feature of the principal reason for a change. The feature is this: With a one per cent grade line located over a hill and also in these cases close to the ground, to save as much grading as possible, in order to grade their one per cent railroad as cheaply as possible. You come then with a five-tenths per cent grade. If you follow that old line, of course you do not climb as fast as you would with a one per cent grade, and the result is if your hill is of any length—say it was a mile long—the difference between one per cent and five-tenths per cent is approximately 26 feet; your cut on your five-tenths would be 26 feet at the top of the hill; two miles long it would be 52 feet, and three miles long it would be 78 feet added, and there you are. If you are changing a hill three miles long you cut into seventy odd feet to get at the top of the hill, which is through solid rock in most cases and impracticable. You can not go up against it.

Q. What was the condition at this place [indicating]?—A. Almost the same as I outlined.

Q. What was the distance?—A. That line change is something like—I think the long side of the hill was something like two miles, if I am not mistaken.

Q. The long side of the hill?—A. Yes, sir.

Q. Where the cut would have to be made?—A. Probably fifty feet.

Q. You avoided that by going around the hill?—A. Yes, sir.

Q. And putting in bridges?—A. Yes, sir.

Q. And an embankment to protect it against the stream?—A. Yes, sir; it figures out cheaper in dollars and cents.

Q. What particular traffic is carried over this line from the north?—A. From the north?

Q. Yes.—A. It is different commodities, such as packing-house products, merchandise, and grain for export.

Q. Has there been any change in that—had you some other commodity to mention?—A. Those are the principal ones.

Q. What particular traffic was in view at the time these changes were made?—A. The particular traffic was the export traffic south, and the lumber traffic north, and the coal north.

Q. I will ask you now what traffic from the south?—A. The traffic from the south is mostly lumber and fruit.

Q. Lumber and fruit?—A. Yes, sir.

Q. You had then in view the development of the export grain trade to the south and the increasing fruit and lumber trade from the south to the north?—A. You can include coal in the northbound movement. That is the principal movement.

Q. And coal?—A. Yes, sir.

Q. What changes have been made in that as to the volume of it, speaking approximately and generally, since this road was laid?—A. That is a traffic feature.

Q. That is, you would not know?—A. I am not a traffic man—no, sir.

Q. When you were called upon to decrease these grades, was it stated to you or was it before you as an engineer the traffic that was to be provided for?—A. The figures that I had at that time were as to the tonnage at that time. I did not go into the feature of the rates or the class of traffic.

Q. You took the total tonnage of the road?—A. I took the tonnage; yes, sir.

Q. Do you know whether there had been any material increase in that tonnage prior to the making of these improvements?—A. Oh, it increased from year to year; yes, sir.

Q. It has increased from year to year?—A. Yes, sir; up until the time this work was started.

Q. Were these changes in these six locations compelled by the increase of traffic?—A. Yes, sir; they were compelled by increase in traffic and the anticipation of a further increase.

Q. The improvement then is a part of an improvement which is to be carried on to completion to meet a future increase in the traffic of the road?—A. It has to be completed as the traffic justifies—as the business justifies.

Q. What do you mean by "the traffic justifies"?—A. You have a certain amount of traffic to handle, and you figure whether you are justified in going to the expense of revising or reducing a division on the basis of what you will save in handling so much traffic. If your saving is not enough to justify the cost of doing the work, of course the work is not done unless you can anticipate a future that will take care of it.

Q. In making these improvements, did you anticipate a future increase?—A. Yes, sir; there was a future anticipated on that for the reason that in our figures we figured what the saving would be in operation for a 100 per cent increase and a 200 per cent increase; they were submitted to the owners of the property, and they could plan for themselves about what they could figure on to take care of this increase.

Q. When you speak of that increase of 100 per cent you mean the increase upon the entire line and not over these particular portions that are improved?—A. Oh, no; each district. We went over each district, and took them separately.

Q. With the view of improving the balance of the line so that it could carry a like traffic?—A. Oh, yes. Some parts of the line will probably be operated for a considerable term of years under the present grade lines.

Q. If the traffic increased, say, 50 per cent, and you can take care of it economically over these parts of the line that are improved, how will you take care of it over the parts of the line that are not improved?—A. There are several different ways; mostly in the power.

Q. Is it not entirely the way, by increasing the power?—A. You can do that by increasing the power—by adding helper power—not increasing the weight of the power. You increase the number, but not the weight. We have increased the weight in a number of cases and put in Mallet engines.

Q. How long will it take to complete these improvements over the line?—A. That depends solely on the increase in the business.

Q. That is, the demands of the business?—A. That is it; yes, sir.

Q. When the business increases so as to demand it then the work will progress; if it does not, then it will be either suspended or move over slowly?—A. Probably so; yes, sir.

Q. So far as the traffic moving over the road at the time these improvements were projected, was there any difficulty in handling the traffic at that time?—A. They experienced difficulty in handling traffic at that time; they had congestion, and in a number of cases the operations were costing more than they should have cost them.

Q. Aside now from the cost of operation, I want to speak of the volume of the traffic. Was there any difficulty at that time in handling the traffic that was then passing over the road, either from the north to the south or the south to the north?—A. To what difficulty do you refer?

Q. Such difficulties as would suggest these improvements.—A. Oh, yes; yes, sir.

Q. There was?—A. Yes, sir.

Q. Where was it manifest?—A. It was manifest in the heavy grades. That is where it was manifest.

Q. At these points where you made the improvements, or at other points?—A. Those as well as other points.

Q. Where did the congestion take place to which you refer?—A. The congestion would take place on probably the entire line if business was like it was a year or so before—

Q. That is the southbound business might be held up at Kansas City? You mean that?—A. Be held up at Kansas City?

Q. Yes.—A. There would be slow movement all the way down the road. We would probably take it at Kansas City and get it out as soon as we could. Then it would not go through without delay. There would be small, short trains waiting on power, and all that sort of thing.

Q. The increased traffic could only be taken care of then by reducing the grade or increasing the units of power at the high grade points?—A. Those are two ways it could be taken care of, and those are the most important ways.

Q. So far as it was provided for, before these improvements were made, it was taken care of as it is now taken care of upon the other parts of the road, by increasing the units of power?—A. Yes, sir.

Q. And these improvements on grade so far as the traffic then existing was concerned were for the purpose of reducing the units of power and increasing the time of service?—A. Time of service, and increasing the movement. In other words, we would be in shape to make more improvements over the line, because we could clean our yards of long trains and keep them moving in that way.

Q. Did you understand the traffic as it existed at that time, if it did not increase in the future was understood to justify these improvements?—A. The improvements made or undertaken were justified by the traffic at the time this report was made.

Q. You mean the traffic then existing?—A. Yes, sir.

Q. It justified the making of these improvements?—A. Yes, sir. And understand with the substantial increase as was made in the few years preceding, it was very likely or very reasonable they could anticipate. But the traffic in the heaviest year before we made the improvements justified, as I remember it, the expense of those particular lines.

Q. Just what do you mean by justified?—A. I mean the saving in the cost of handling the traffic.

Q. Were the improvements necessary to maintain or retain the traffic as it then existed?—A. As far as I know it was.

Q. As far as you know it was?—A. Yes.

Q. That is to say the traffic at that time demanded that these improvements should be made, other than the matter of reduction in cost of operation?—A. I think so.

Q. That is, to take care of the traffic?—A. I think so.

Q. These improvements were required?—A. I think so.

Q. As you understand?—A. It was good practice that they go ahead and make the improvements.

Q. How much weight was given to the probable increase in the future?—A. That was a matter that was threshed out wholly by the board of directors, and I was not at any of their meetings.

Q. You do not know whether that was a consideration or not, the future increase of traffic?—A. Those things involved traffic arrangements and such as that, with which I am not familiar.

Q. I call your attention again to this improvement of about 80 miles in the first red lines. Were the changes made there strictly in accordance with the report of Mr. Burt?—A. Yes, sir.

Q. Did not his report as made to the board of directors involve a more radical change of line than is shown here?—A. His report involved a number of propositions. The board of directors selected for themselves which one they wanted to undertake.

Q. Of course the report speaks for itself?—A. Yes, sir.

Q. I am speaking now of the written report, the recommendations of Mr. Burt. Did not he recommend a line more closely located to Fort Smith?—A. Yes, sir.

Q. That line was not adopted?—A. That line was not adopted; no, sir. It was modified—the recommendation was modified.

Q. Do you know why?—A. There are a number of things entering into it. Mr. Burt's recommendation was that we move a division from Pittsburg to Joplin and then have the run from Joplin to Fort Smith. The sixteen-hour law killed that. That is one reason they modified it.



Q. What is that?—A. The hours-of-service law. We could not get over that longer territory. That was since his report.

Another thing was the cost of bridging the Arkansas River.

Q. That would have necessitated a change in the bridge?—A. Oh, yes; we would have to build a new bridge to go into Fort Smith.

You might say the balance is the cost as between the two propositions.

Q. The cost of the proposition as made by Mr. Burt, as recommended by Mr. Burt in his report, would have been more than the cost of making the changes as they were made and as they are shown upon this profile?—A. That matter you understand was handled strictly by the board of directors in arriving at which particular plan they should follow. Mr. Burt figured on the future of Fort Smith. Probably the board of directors did not think that Fort Smith would have such a future. There are several different things that caused the modification of the recommendation in that respect.

Q. Mr. Burt then was figuring not only on the line of reducing the grade, but also locating the line with reference to future traffic—prospective traffic?—A. In that particular case he considered that Fort Smith was a very important point to have on the main line. But that is the only instance that I can recall where he did figure on opening up new territories by his lines.

Q. What would have been the difference in the length of the line if the Fort Smith line had been adopted?—A. As I remember it was something like 30 miles longer.

Q. Thirty miles?—A. I may be mistaken. I can find it in my notes.

Q. Will you refer to your notes, please, and give us the exact figure.—A. I mean in his report.

The Court. We will take a recess until 2 o'clock.

Thereupon, at 12:30 o'clock p. m., a recess was taken until 2 o'clock p. m.

#### AFTER RECESS.

TUESDAY, DECEMBER 10, 1912—2 O'CLOCK P. M.

The court met after recess and the trial proceeded, as follows:

CHARLES E. JOHNSTON, the witness on the stand at the time of taking the noon recess, resumed the witness stand, and is further cross-examined.

By Mr. NEEDHAM:

Q. You were computing the mileage of that piece of road. Did you complete it?—A. Yes, sir; it is 16 instead of 30 miles.

Q. So it would increase the length of line 16 miles to have taken in the new territory?—A. Yes, sir.

Q. And that the company declined to do?—A. Yes, sir.

Q. Is it not a fact, borne out by your work and experience in this improvement, that these improvements done and planned for the future were primarily to take care of the traffic existing on the entire line and to be secured in the future upon the line as it was located, rather than to seek new territory?—A. No, sir; I cannot say that it was.

Q. Was there any change made that looked to the securing of new territory?—A. There was no change made; no, sir.

Q. No change made?—A. No, sir.

Mr. WICKWIRE. Are you speaking now with reference to this recommendation of Mr. Burt's that was not accepted, and the purpose of that?

Mr. NEEDHAM. The purpose of this 16 miles of additional road, as I understand it, was to reach new territory, and that was rejected. I want to ask him if it was not the purpose of the road to improve the road for existing and new traffic over the road rather than to seek new territory.

By Mr. WICKWIRE:

Q. Am I to understand from your answer that you mean it was the purpose of the railroad to seek new territory for these improvements?—A. Oh, no; I do not mean that at all. From the question I assumed that he had reference to future expansion, bringing in new lines, and handling the volume of business from the new lines over this main line.

By Mr. NEEDHAM:

Q. I do not refer to any plan for construction of branch lines, as counsel did.—A. That is the way I understood you.

Q. But I refer to improvements of main lines solely. Was there embodied in that any plan for new territory or changing lines so as to secure new territory?—A. No, sir; there was not.

Q. The improvements which were made were upon those sections of the road where the greatest mileage could be covered at the minimum expense in reducing the grade to 0.5 of one per cent, leaving the more expensive improvements to secure that end for future work?—A. It resolves itself in a way to that. It assumes that rather automatically, because—

Q. (Interrupting.) How did you come to select this particular first section, for instance, instead of taking any other section between there and Kansas City, where the grades are considerably above one per cent?—A. For the reason that that saving in cost on that territory, with the traffic moving over that territory, could be made with less cost than it could on some other particular district.

Q. That is to say, you could secure a greater mileage there with the same expenditure at a grade of one-half of one per cent than you could over any other section of the road?—A. The mileage does not—it has to affect an engine district, and we could get that result on that engine district at a lower cost than we could on some other.

Q. That is the reason why you selected that?—A. That is the reason.

Q. As the first improvement to be made?—A. Yes, sir; because we could realize on it at an earlier date.

Q. Leaving the more expensive districts to be improved later?—A. Yes, sir.

Q. I see you have marked upon this plat "Mallet locomotives." Those are used as furnishing extra units of power over high grades, are they not?—A. Yes, sir.

Q. And that is the way in which you take care of the traffic over those high grades, and will until you can reduce the grades to one-

alf of one per cent?—A. That is the way we are operating those  
ow.

Q. Then, I conclude that the plan of grade reduction which you  
dopted is ultimately for the whole line?—A. Yes.

Q. And that you began on these divisions of the line where you  
ould accomplish the greatest results for the minimum amount of  
oney?—A. For the least money; yes, sir.

Q. Leaving the others to be taken care of later?—A. Yes, sir.

Q. Referring now generally to your testimony and to sum it up,  
hese improvements were necessary, or made necessary, in order to  
ake care of the growing traffic over the entire line; first, to reduce  
perating expenses, and, second, to meet the demands for more  
efficient service?—A. To meet competition.

Q. That is, the demands of the traffic in order to take it over your  
ne?—A. Yes, sir.

Q. That shop is on a new site, is it not, at Shreveport, on an en-  
tirely new site?—A. No, sir; not an entirely new site.

Q. Partly on a new site?—A. It is owing to what you limit the site  
o. The old shop is, you might say, on the same site, but the new  
shop proper is located on the site of a different location than the old  
shop, on a different corner of the plat of ground.

Q. Was there any new ground purchased for it?—A. Yes, sir;  
here was an additional strip secured or procured for that purpose.

Q. But the building is entirely independent of the old?—A. Oh,  
es.

Q. And the old building has been given up?—A. Yes, sir.

Q. You used the word "obsolescence" in your testimony. What  
o you mean by "obsolescence"? To call your attention directly to  
hat testimony, you said that the old pieces of road were in good con-  
ition and that there was no obsolescence of the old road. What do  
ou mean by "obsolescence"?—A. I mean the old road was per-  
ectly good to handle the traffic for which it was originally located  
nd constructed—the volume of traffic. It was not obsolete.

Q. And therefore you say it was not obsolescent?—A. Yes, sir.

Q. You used the term, then, in the sense of wear and tear?—A. It  
as not run down in the sense of wear and tear. It was in good  
epair.

Q. In what sense do you use it, and what definition do you give to  
he word "obsolescence" as you have used it in your testimony?—A.  
do not remember of the case where I used the word "obsolescence."

Q. You used it twice, or it was used in the questions, perhaps, to  
ou.—A. It was in the question, perhaps.

Q. But you replied to it.—A. I replied and said "inadequate," I  
hink.

Q. Then, you did not apply to the conditions of the road or the  
onditions of the traffic, as regarding this improvement, the word  
obsolescence"?—A. No, sir; I would not apply it.

Q. What would you call it?—A. I would say the conditions of the  
ld line were inadequate to handle your present volume of business  
nd to meet competition. You have to make additions and better-  
ments to meet the requirements.

Q. If you were asked to put the reason in a short answer, one word  
or a few words, what would you say were the causes that compelled the

making of this grade reduction?—A. Demands of the public—public demands.

Q. The old road in its then existing condition being perfectly good to serve the purposes for which it was constructed, being inadequate to meet those demands?—A. Yes, sir; that is the way I would put it.

Mr. NEEDHAM. I think that is all.

Redirect examination by Mr. WICKWIRE:

Q. Will you state whether the reasons for making the changes by these new locations were the same reasons that applied in respect to the locations of the original right of way?—A. Yes, sir; they were.

Q. Was there any difference in the purpose or end to be subserved in the two methods employed?—A. No, sir.

Q. The increased efficiency which was secured from the railroad as a whole has been secured, as I understand you, by increasing the train load upon various sections without additional motive power, and in those places in which there are still very heavy grades you use an additional unit of power in the form of Mallet engines?—A. Yes, sir.

Q. The net result of the changes, as I understand you, is to increase the efficiency of the whole line?—A. Yes, sir.

Q. And this will result in an increase of net earnings?—A. Yes, sir.

Q. With respect to the shop at Shreveport, state whether or not that shop was a part of a larger improvement involving terminals.—A. Yes, sir.

Mr. NEEDHAM. Terminals at Shreveport?

Mr. WICKWIRE. Yes; at Shreveport.

The WITNESS. Yes, sir.

By Mr. WICKWIRE:

Q. Just state briefly to the court what the situation was in that regard and what has been accomplished.—A. The old facilities at Shreveport were not facilities that would correspond with the other general improvement work of handling increased traffic. The number of engines and the great amount of car-repair work necessary made it necessary to entirely expand the entire layout, and inasmuch as the traffic demanded the more prompt dispatching of engines to handle their traffic, it was necessary to increase these facilities entirely, which includes the track layout as well as the shop facilities.

Q. What are the principal items in respect of which a saving is effected by the reduction of the grades upon a portion of the line and by the use of the Mallet engines over the very heavy grade?—A. Your saving comes in train wages and fuel, principally.

Q. Are the repairs to the locomotives an important item?—A. The work that you put on your locomotives on account of heavy loads on the heavy grades of course runs your item of engine repairs up to a considerable figure. It is quite an item.

Q. You mean on the line as it stood before?—A. The old line, where we are operating the heavy power now. It will apply there on the heavy grade.

Q. But upon the other sections of the line the expense is reduced, is it not?—A. It is; the expense of your locomotive repairs is reduced.

Q. In stating on your cross-examination that the reason for making these changes was on account of the inadequacy of the railroad as it was, did you mean it to be understood that the railroad was inade-

quate for the traffic for which it was originally designed and for which it has been used for many years, or with respect to the constantly increasing demands made upon it?—A. The way I intend the reply was that the old line was adequate to handle the traffic for which it was built and you may say for a number of years after it was built. But the present demand and the anticipated volume of traffic makes it inadequate.

Q. Was the element of competition—the necessity to compete with other lines—an important factor in the determination that these improvements should be made?—A. Yes, sir; it was one of the greatest factors.

Mr. WICKWIRE. That is all.

Recross-examination by Mr. NEEDHAM:

Q. This inadequacy of which you have spoken with reference to the line of railroad applies, as I understand it, to the Shreveport terminal?—A. You could make the same apply. It would apply; yes.

Q. You were asked as to whether there was a difference between improvements made upon the line and those made off the line; that is, as to the purpose. The purpose in both cases was to secure a one-half per cent grade, was it not?—A. A grade reduction; yes.

Witness excused.

A. H. PLANT, a witness of lawful age, called by and on behalf of the petitioner, being first duly sworn, is examined.

By Mr. WICKWIRE:

Q. Will you state your name?—A. A. H. Plant.

Q. What is your residence?—A. Washington, D. C.

Q. And your occupation?—A. Comptroller of the Southern Railway Company and its allied lines.

Q. How long have you occupied the position of comptroller?—A. I was appointed auditor of the Southern Railway Company January 1, 1898. In 1905 the position of comptroller was created, and I was elected to that position. I have held it ever since.

Q. What was your experience in accounting prior to your connection with the Southern Railway?—A. I entered the accounting department of the railroad in 1885. Since that time I have been continuously in the accounting service, having had charge during that time of practically all classes of accounting work. Prior to that time I was connected with the agency department of the railway service, beginning with July 15, 1871.

Q. Then you are very familiar with the railway accounts, are you not?—A. I believe I am; yes, sir.

Q. You are familiar with the regulations of the Interstate Commerce Commission in respect of accounts?—A. Yes.

Q. Are you familiar with the issues involved in this case?—A. To some extent; yes. I cannot say that I am thoroughly familiar with them, but I have before me all the details.

Q. In relation to the regulations of the Interstate Commerce Commission in respect to the classification of additions and betterments, and the treatment of property abandoned in connection with making grade revision, the testimony in this case is to the effect that upon six portions of the line where the company determined to revise its

grade to a maximum of five-tenths of one per cent, it was found that the improvements could be made by a relocation of the line on other ground at an expense approximately only one-half as much as upon the original locations. It appears also in the evidence that the estimated expense of these revisions upon the old line of road was about \$1,200,000, and the estimated expense upon the new location was approximately \$600,000. It is also shown that, deducting the estimated replacement cost of the line abandoned in connection with improvements upon the new location, the railway company would be permitted, under the regulations of the Interstate Commerce Commission, to make, for the improvement costing about \$600,000, a charge to additions and betterments amounting only to \$231,000, and that the estimated cost of the abandoned portion of the line, which, less salvage, was chargeable to operating expense, amounted to the difference, or to approximately \$400,000. Will you state whether, in your opinion, the estimated replacement cost of these portions of the line abandoned in connection with and as an incident to grade reductions, was properly chargeable to operating expenses?—A. I would consider the values representing the property abandoned to be an improper maintenance charge, understanding as I do the purposes of what we term our operating cost.

Q. Will you be good enough to state the reasons for your opinion?—A. The main reason is the abandoned values that have nothing whatever to do with maintenance.

Q. By maintenance you mean part of operating expense?—A. Keeping up an existing property; yes, sir.

Q. Will you state what are the elements of operating expense properly and normally?—A. First, we have the maintenance costs, which are understood to represent the cost of keeping the property in a growing condition; that is, to take care of the upkeep of the property. Another cost is that of transportation; that is, the cost to transport traffic over the line.

Q. The current expense of obtaining earnings?—A. Yes; and keeping the property up to a proper standard of efficiency.

Q. In your judgment the property which was abandoned incidentally to this grade improvement was not a maintenance charge, and was not any other element of operating expense?—A. I do not so consider it. I would not consider it at all a maintenance charge, under the purpose for which I understand operating classification was produced.

Q. State whether or not, it appearing in the evidence in this case that the change upon these six sections of line enhanced the value of the entire railroad in an amount at least equal to the cost of these six sections, the expenditure necessary to make these six improvements was properly chargeable to additions and betterments, and ultimately to go into the property account.—A. I do not know that I am sufficiently familiar with the Kansas City Southern conditions to give a very definite answer to that question; but it seems to me the cost of reconditioning the road under those circumstances represented increased investment in the property, and as it was likely to produce economies in operation and increased traffic, it would seem to be a proper additions-and-betterments charge.

Q. You know, do you not, that under the regulations of the Interstate Commerce Commission substantially all of the expenditure for

those six improvements had they been made upon the original right of way would have been chargeable to property accounts?—A. Yes; that is my understanding of the rule.

Q. Do you know of any reason for a distinction in accounting between these improvements made by these two different methods?—

A. For practical purposes I can not recall any very great difference. You have an element of abandonment of old line, of the old roadbed, when you cut down a hill or fill a valley. You have practically, as I see it, the same element of abandonment in so far as the service of the track is concerned that you have when you get off the old roadbed and build a new one.

Q. In other words, if you go down fifty feet on the original roadbed for the purpose of getting a grade reduction, or if you go off to one side fifty or one hundred feet to secure the same grades, there should be no substantial difference in the method of treating that expenditure?—A. I have never been able to see why there should be.

Q. Would you say that you would treat this additional expense as the cost of progress?

Mr. NEEDHAM. That is rather a leading question, and I do not understand what you mean by it. He can give the reasons; I do not object to that; but I rather object to the form of the question.

Mr. WICKWARE. Perhaps it is objectionable.

By Mr. WICKWARE:

Q. Will you state whether or not it has been your experience that, with the development of the country, roads require to be improved and additions made thereto from time to time to meet the requirements of successive periods?—A. Yes. There is a general demand, as I see it, of increased facilities and improved facilities all over the country. Most of the railroads as originally constructed were adequate at the time of their construction, possibly, to the traffic demands at that time; but the conditions of the country have outgrown a great many of those facilities, and there is and has been for some time past a traffic demand for increased and improved facilities. Furthermore, our main elements of expense are going up all the time, in the way of prices of the material and increased labor costs, which have to be met by improved facilities. It is necessary to overcome, as far as possible, these increased costs by increasing the thing we do, namely, our trainload. To do that we must have increased facilities; we must have lower grade lines and larger facilities and modern machinery.

Q. Suppose, in respect of these particular improvements, the original roadway had not been abandoned, but had been kept in use and for storage purposes, or for sidings or occasionally running trains over them, is it your understanding that, under the regulations of the Interstate Commerce Commission, substantially the entire cost of these six new locations could have been charged to capital account?—A. I so understand the rule.

Q. Do you regard those variances as reasonable in the accounting regulations?—A. To which variances do you particularly refer now?

Q. I mean the provision that, if the road is immediately abandoned, the estimated replacement cost must be charged to operating expenses, but if the road is kept in use for slight purposes, the entire improvement may be charged to capital account and no charge made

to operations? Do you regard the regulations as consistent in those two cases?—A. I can see no inconsistency. In the first place, if you made your line by building a new one and still retained the old one, you have certainly got an increase in your property. You have two lines instead of one. If you subsequently abandon the old line, say two or three or five years after the new one is constructed, then you have a loss, which, as I recall it, would properly go under the rule with respect to taking care of abandoned property not replaced.

Q. And in case of that subsequent abandonment, a year or two later, would any amount then be chargeable to operations or would the amount be chargeable to profit and loss?—A. I should think, under those conditions—

Q. (Interrupting.) I mean under the regulations.—A. Yes, sir; I understand. I should think that if property is abandoned under those conditions and several years after the new line is built, it should be treated in the same way as abandoning a spur track or branch line. It should be properly chargeable to profit and loss.

Q. It would not, according to your understanding, be in any way chargeable to operating expenses?—A. With the understanding that when the new line was built it was the intention and purpose at that time to keep up the lines. Of course, if the general scheme was known at that time that the old line would be abandoned, that might alter the situation somewhat.

Mr. WICKWIRE. You may cross-examine.

Cross-examination by Mr. DENISON:

Q. You were chairman of the standing committee on corporate, fiscal, and general accounts of the Association of American Railway Accounting Officers, were you not?—A. Yes, sir.

Q. And you participated in the consideration of this matter prior to the promulgation of the rules by the Interstate Commerce Commission?—A. Yes.

Q. Were you at the Buffalo conference in June, 1907?—A. I do not recall, but I presume I was.

Q. Is this paper which I show you, which is marked "Bulletin No. 28," the result of the discussions of that conference on this subject?—A. I will have to examine the bulletin to see whether it is or not [After examination.] Yes, sir; that classification was considered at that meeting, and this bulletin so indicates it.

Q. And this bulletin indicates the recommendations of that meeting, does it not?—A. I can not say as to that; no. I do not think it does, although I am not positive.

Q. Does it not state that it represents the conclusions of the standing committee on a tentative classification for additions and betterments?—A. It so states.

Q. At any rate, it is what its face indicates that it is?—A. Yes, and I would say that up to that time it represented the work done thus far by the committee with respect to the classification of the additions and betterments, but it is not final.

Mr. DENISON. I offer this in evidence.

The document, "Bulletin No. 28," referred to by counsel was thereupon marked "Respondent's Exhibit C," and is filed herewith.

The WITNESS. May I add a word to my answer to that question?



By Mr. DENISON:

Q. Yes; proceed.—A. I stated in my answer or intended to state that the classification for additions and betterments as produced in Bulletin No. 28 was the result of the deliberations of the committee on corporate, fiscal, and general accounts up to that time, but that the conclusions reached thus far were not final, and I think you will find stated in Bulletin No. 28 that that classification was to be referred to the individual members of the association, the companies, for their consideration.

RESPONDENT'S EXHIBIT C.

(Printed in part.)

Bulletin No. 28.

ASSOCIATION OF AMERICAN RAILWAY ACCOUNTING OFFICERS.

Standing committee on corporate, fiscal, and general accounts: A. H. Plant, chairman; M. Riehemueck, R. A. White, M. P. Blauvelt, G. N. Wilson, G. E. Hustis, W. J. Hobbs, H. W. Walker, Chas. Haydon, W. N. D. Whinn, C. I. Sturgis, C. F. Krebs, E. Young, Robert Toombs, R. I. Farrington, H. A. Gray, W. E. Bailey, S. B. Schuyler, S. C. Johnson, M. M. Kirkum, J. W. Renner, H. D. Bulkey, P. A. Hewitt, F. Say, L. H. Stewart.

OFFICE OF THE CHAIRMAN.  
Washington, D. C., June 17, 1907.

To members of the Association of American Railway Accounting Officers.

GENTLEMEN: I beg to submit herewith the results of the deliberations of the standing committee on corporate, fiscal, and general accounts at its meeting held at the Iroquois Hotel, Buffalo, N. Y., June 13 and 14, 1907.

1st. Extract from minutes of the meeting, including organization of the committee:

2d. Tentative classification of additions and betterments expenditures, including text therefor.

It is understood by the committee that it is the purpose of the Interstate Commerce Commission not to promulgate through official order at this time the classification and text for additions and betterments expenditures, but that such classification and text will be submitted to individual lines by the commission, asking for suggestions and recommendations in respect thereto.

Respectfully submitted,

A. H. PLANT, *Chairman*.

P. S.—The notice of members is particularly called to the resolution adopted by the committee set forth on page 5, requiring prompt attention.

C. G. PHILLIPS, *Secretary*.

The committee proceeded to the consideration of the tentative classification of additions and betterments.

The following preamble and resolution were adopted:

"Whereas it is recognized by the standing committee on corporate, fiscal, and general accounts of the Association of American Railway Accounting Officers that the matter of classification of additions and betterments expenditures includes matters of financial policies of carriers, and that while the committee has formulated such classification and text therefor, it is felt that the whole subject should be submitted to the executive officers of lines members of the association; Therefore

"Resolved, It is the sense of this standing committee that before this bulletin is submitted to the Interstate Commerce Commission that such members of the association as desire to submit the same to their executive officers for any suggestions be permitted to do so, and have their answers to the chairman of this committee, Mr. A. H. Plant, comptroller, Southern Railway, Washington, D. C., before the 1st of July, 1907, and that the letters submitted to the chairman of this committee be transmitted to the Interstate Commerce Commission with the classification and text."

The tentative classification of additions and betterments expenditures and text therefor was adopted in the form attached hereto.

C. G. PHILLIPS, *Secretary*.

**CONCLUSIONS OF STANDING COMMITTEE ON CORPORATE, FISCAL, AND GENERAL ACCOUNTS ON TENTATIVE CLASSIFICATION OF ADDITIONS AND BETTERMENTS EXPENDITURES AND TEXT THEREFOR.**

*NOTE.—The classification of construction and equipment expenditures applies equally to the construction and equipment of new main and branch lines.*

**5. GRADE REVISIONS AND CHANGES OF LINE.**

To this account should be charged:

**GRADE REVISIONS.**—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment. The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels, and grading outfits, tools used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences, buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway-crossing alarms, and watch houses.

*NOTE A.*—The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; rebalasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection; should all be charged to appropriate operating-expense accounts.

*NOTE B.*—When, in reducing grades, grade crossings are eliminated and overhead crossings substituted therefor, the cost of grading the highway or street approaches to the new crossings, the overhead bridge with its abutments, piers, and posts, should all be charged to account "Track elevation, elimination of grade crossings, etc." In case undercrossings are substituted for grade crossings, the cost of the undercrossing is a portion of the cost of the grade revision and should be charged to this account.

**CHANGES OF ALIGNMENT.**—Cost of changing alignment for purposes of reducing curvature, cutting out bridges, tunnels, etc. The amount to be charged to this account for work of this description is the excess cost of the grading and bridging done, over the actual cost, or, if actual cost unknown, estimated original cost, of that portion of the grade, bridges, tunnels, etc., on the old line that will be abandoned or rendered unnecessary.

*NOTE.*—The explanations given under "grade revisions" as to the items constituting cost of grading, the portion of that cost and of the cost of track work of all kinds, chargeable to operating-expense accounts, and charging the cost of new overhead crossings, apply equally to changes of alignment.

**CHANGES OF LINE.**—Cost of building new lines, exclusive of cost of right of way therefor, which should be charged to account "Right of way and station grounds," for the purpose of improving both grade and alignment, over the actual cost, if known, or estimated original cost, if actual cost unknown, of the line to be abandoned. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs and switches, track fastenings, and other track material; ballast, tracklaying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovels, and other work equipment, engines, cars, and crews employed in the work.

*NOTE A.*—Cost of buildings, water, and fuel stations and similar structures on new lines should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate additions and betterments and operating-expense accounts, as provided for in the

various accounts herein relating to the different classes of buildings and structures.

The actual or estimated original cost, as the case may be, of the line to be abandoned, exclusive of right of way and station grounds and of buildings as above, with the cost of removal of tracks, bridges, etc., but less salvage, should be charged to the appropriate operating-expense accounts.

NOTE B. All expenditures charged to account "Grade revisions and changes of line" should be classed as "betterments."

## 20. SHOPS, ENGINE HOUSES, AND TURNABLES.

NOTE.—Expenditures charged to this account will be classed as "additions" or "betterments," according to the following definitions:

ADDITIONS.—To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); engine houses (including turntables, cinder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and outhouses in connection with additional buildings; additional oil houses, sand houses, storehouses for company's material, scrap bins, appurtenances, etc.; also cinder pits, drop pits (outside of engine houses), and turntables where none before. This account should include amounts paid when erected by contract; labor and material when built by company; preparing grounds before and clearing same up after construction; foundations and painting; excavation for and lining of additional turntable pits, and of cinder or drop pits inside or outside of additional engine houses; foundation for additional turntables; loading, unloading, and placing turntables in position; levers, tractors, and spurs for handling turntables; sewerage systems, connection with water supply system, and shop wells for additional buildings; architect's fees for drawing plans for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses and cost of all tracks laid in any additional building above described, on transfer and turntables in connection with such additional buildings and landing from such transfer or turntables into additional shops and engine houses.

When shop buildings (with their appurtenances as above described), engine houses, or turntables are removed and not replaced, the original cost thereof, or, if original cost unknown, their estimated original cost, should be credited to this account and charged, less salvage, to the appropriate operating-expense account, to which account should also be charged the cost of their removal and of restoring the grounds to proper condition, including filling foundations, wells, turntable pits, etc.

BETTERMENTS.—To this account should be charged the excess cost of new buildings to be used as shops, car sheds, and engine houses, and of new transfer tables, turntables, cinder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for furnishing power or for heating and lighting existing shop buildings, engine houses, etc., when such plants not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, sidewalks, and outhouses in connection with existing shop buildings or engine houses; excess cost of enlarging, altering, or rebuilding oil houses, sand houses, storehouses for company's materials, scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing engine houses where no pits previously; tractors or other apparatus for handling existing turntables, enlarging and deepening shop wells; excess cost of reconstructing water supply and sewerage systems for shops and engine houses over cost of replacing the existing; cost of fences and hedges on or around existing shop grounds or buildings, where not previously fenced; all expenses incident to paving and draining existing shop grounds or grounds around existing shop buildings, engine houses, etc.; and excess cost of extending, rearranging, or relaying tracks in shop buildings or engine houses, on transfer or turntables in connection therewith, or of tracks leading from such transfer or turntables into shop buildings or engine houses, over the cost of replacing the existing tracks.

Q. The resolution which is cited at page 5 of this bulletin is that "it is felt that the whole subject should be submitted to the executive officers of the lines." That was done, was it not?—A. I can not say as to that. I can answer only for my own actions.

Q. Did you not send this out to the executive officers of the lines and receive replies from those executive officers?—A. If I recall it, the bulletin was submitted by the members to their respective executive officers.

Q. And the replies came to you, did they not?—A. Some of them, and some did not; yes.

Q. And among the replies that you received there were at least some that approved the recommendations as stated in the Bulletin No. 28?—A. I do not recall that; no, sir. That may be true.

Q. The meeting at Buffalo was a meeting of accounting officers, was it not, as distinguished from executive officers?—A. It was a meeting of the committee of accounting officers.

Q. And it was that committee of the accounting officers that made this tentative recommendation covered by Bulletin No. 28?—A. Tentative recommendation?

Q. Yes. I take the word "tentative" because of what you said.

Mr. WICKWIRE. I object to that on the ground it is not predicated on any facts.

Mr. DENISON. The bulletin itself at page 5 describes it as a tentative classification.

By Mr. DENISON:

Q. That was the product of this committee of accountants, was it not?—A. No; not entirely. I think the classification as there presented was largely the product of the representatives of the Interstate Commerce Commission.

Q. It was passed by the committee, was it not?—A. It was considered by the committee; yes.

Q. It was considered and it was passed by resolution of the committee, was it not?—A. Not finally. If the committee had finally passed it and considered that they were through with it, I doubt very much if they would have referred it to their executives for their consideration and advice.

Q. Is this bulletin correct or incorrect in stating that these things are the conclusions of the standing committee on corporate, fiscal, and general accounts on tentative classification of additions and betterments expenditures?—A. Up to that time; yes.

Q. And it represented the tentative views up to that time of the committee, did it not?—A. Of a majority of the committee, yes; up to that time.

Q. And that committee was a committee of accountants, was it not?—A. Yes; but it was not their—

Q. (Interrupting.) How large was the committee?—A. That bulletin has no letter attached to it, has it? It is simply No. 28?

Q. It has an extract from the minutes.—A. What is the number of the bulletin?

Q. No. 28.—A. That was considered by the committee, consisting of twenty-five accounting officers. The bulletin itself indicates the number of those accounting officers present at that meeting, or it should indicate them.

Q. It states that the roll call disclosed that all members of the committee were present or represented, with the exception of Mr. H. W. Walker; that Mr. Winne was represented by Mr. Dudley, and Mr. Kirkman was represented by Mr. Clifford. Who was Mr. Dudley and who was Mr. Clifford?—A. Mr. Clifford was with the Chicago & North Western.

Q. Was he an accountant?—A. Yes, sir.

Q. Was Mr. Dudley an accountant?—A. Yes.

Q. Was there any representative of the Interstate Commerce Commission present at the Buffalo meeting?—A. The bulletin should indicate. I do not recall it.

Q. You do not recall any being present?—A. We have had so many of these meetings that I could not possibly tell you who were at any individual or particular meeting. The bulletin should show, though, who were present. I think Mr. Adams was at that meeting. I am not sure. My recollection is that he was present at that meeting; possibly some of his assistants.

Q. You would not be positive?—A. No; I would not be positive, but the bulletin should show whether he was present there or not.

Q. Was Mr. Adams a member of the committee?—A. Mr. Adams represented the Interstate Commerce Commission.

Q. But he was not a member of the committee?—A. In one sense I consider he was; in another he was not.

Q. He was not of the twenty-five?—A. He was the boss of the twenty-five. He was the most important member of the committee.

Q. You said it was a committee of twenty-five, and in counting the twenty-five you did not count Mr. Adams, did you?—A. The committee was created for the purpose of cooperating with the Interstate Commerce Commission to promulgate a uniform system of accounts.

Q. And advising them?—A. Not entirely. Mr. Adams was delegated by the Interstate Commerce Commission to represent the commission, and the committee of twenty-five and Mr. Adams worked together hand in hand. Sometimes we advised him and sometimes he advised us. We received about as much as we gave, I think, in that respect. I would like to say one thing further in connection with Bulletin No. 28 and the classification of additions and betterments. If you will examine the work of the committee of twenty-five from its beginning in 1906, you will find that the various subjects which came up under this constructive accounting work that we did were considered, and conclusions would be reached at one meeting, and something would be subsequently brought up or would subsequently come up that would materially change those conclusions. Sometimes Mr. Adams would bring up things that would change them; sometimes the accountants would bring up these things that would change them. So we do not consider that that Bulletin No. 28 is at all conclusive. As a matter of fact, the record shows that that classification was given very serious consideration subsequent to the issuance of Bulletin 28 and subsequent to the meeting at Buffalo referred to.

Q. It is conclusive of one thing, is it not, that at that time it was there, and with that knowledge and talk then in their minds a majority of those twenty-five accountants considered that that was not an arbitrary or irrational method of accounting?—A. I will not say that.

Q. You think that the majority of these twenty-five promulgated a recommendation, even tentatively, which they thought was irrational and arbitrary?—A. I think, since refreshing my mind on that, that when that classification was finally acted upon by that committee the committee had dwindled down to about one-half or possibly less than one-half its regular number. I can not say that it did represent a majority of the opinions of that committee at that time. I remember at one Buffalo meeting—and I think it was the meeting that considered that classification—that before we finally concluded our deliberations the committee had dwindled down to rather a small number.

Q. That does not appear in any way in the minutes?—A. That does not appear in the minutes; no.

Q. Do you know how many there were there present at the meeting which finally passed that resolution?—A. No; I do not remember. I do have an indistinct recollection that at the Buffalo meeting we considered that classification, and that a good many of the members got out and went home before the conclusion of the meeting. I will not be entirely positive about that, but that is my recollection.

Q. The whole thing was finished up in two days, was it not? The Buffalo conference was held on June 13 and 14, was it not, and completed in those two days?—A. Yes; but I think there was a subcommittee meeting just before the meeting of the general committee. The subcommittee may have been in session two or three days before that.

Q. But, at any rate, there were a number of your committee who at that time considered that was a reasonable and possible and not an arbitrary and unreasonable method of accounting?—A. I will not say that; no. I will say that the record indicates that the tentative classification was adopted by that committee at that time.

Q. But you will not say that the committee was not irrational?—A. I will not say that, either.

Mr. DENISON. That is all.

Cross-examination by Mr. NEEDHAM:

Q. It is part of your duty to classify the accounts as they are entered in the record of your read, is it not?—A. They are classified under my direction.

Q. In the case of the abandonment of a bridge because—I will use the same term used by the former witness, though I do not know whether you were here or not—of its inadequacy to carry the traffic, and the substitution of a new bridge in its place, how would you enter those accounts, and especially the one with reference to the abandoned old bridge?—A. Are you referring now to the practices on the roads I represent?

Q. I am asking you particularly with reference to your views as an expert accountant or comptroller, not wishing to bring your own affairs into this case; that is all.—A. In the case of an abandoned bridge, or rather in the case of the replacement of a bridge, following the general practice and custom of the roads, bridges, when they have served their purposes or need renewing, especially if they are light steel or wooden bridges, are generally renewed with heavier steel structures. In that case the rule is, as I recall it, to charge the cost to renew the old to operating expense. The difference between

that cost and the cost of the new becomes an addition and betterment charge.

Q. It is the cost of reproducing, less salvage, I suppose?—A. Less salvage. The salvage item enters as a credit to the operating expense charge.

Q. Do you understand in the statement that has been made here that the abandonments in this case were pieces of road, represented on this profile—I do not know whether you have seen it or not—where they found it less expensive, it is stated, to reduce the grade to one-half of one per cent by changing the right of way and running over a new right of way for a given distance, and abandoning the old right of way: do you understand that to be the problem in this case?—A. I so understand; yes.

Q. Suppose a piece of road covering a distance two miles, with a bridge, becomes inadequate for any reason, using the same word, to carry the traffic or the future traffic of the road; that two miles of right of way cost \$100,000 to reproduce it; the bridge cost \$100,000 to reproduce; to make that piece of road adequate, a new line is built connecting the road at each terminus of the two miles that I have referred to over an entire new right of way, crossing the same stream with a new bridge, and it becomes necessary to treat the bridge renewal and the two miles of right of way: how would you treat the bridge in the first instance, assuming the old bridge to cost for renewal \$100,000? What would you do with that item?

MR. WICKWIRE. I think I will have to object to the question as indefinite, because it does not specify the purposes of this change of location.

MR. NEEDHAM. Yes; I said because it had become inadequate.

MR. WICKWIRE. Do you mean that it was worn out?

MR. NEEDHAM. No; no. He said he did not mean worn out by "inadequate." He used the word "obsolescente," as appearing there.

MR. WICKWIRE. Do you mean any difficulty with grades?

MR. NEEDHAM. May be grades; may be curves; I care not what the reason may have been, so long as it was necessary in order to make the road adequate for new traffic, to change that line.

MR. WICKWIRE. It seems to me the question is indefinite. If the witness understands it—

MR. NEEDHAM. Just read the question. I want to make it clear.

The REPORTER (reading):

Q. Suppose a piece of road covering a distance two miles, with a bridge, becomes inadequate for any reason, using the same word, to carry the traffic or the future traffic of the road; that two miles of right of way cost \$100,000 to reproduce it; the bridge cost \$100,000 to reproduce; to make that piece of road adequate, a new line is built connecting the road at each terminus of the two miles that I have referred to over an entire new right of way, crossing the same stream with a new bridge, and it becomes necessary to treat the bridge renewal and the two miles of right of way, how would you treat the bridge in the first instance, assuming the old bridge to cost for renewal \$100,000? What would you do with that item?

A. I would consider that whole scheme as one. I would make no distinction between the two miles of track and the bridge.

By MR. NEEDHAM:

Q. What would you do with the bridge item? You keep a bridge account, do you not, separately?—A. I do not know that I have said

what I would do with any item. My opinion is that the whole scheme should be considered as one scheme. If I had a bridge that, within itself, needed renewal, or heavy repairing, and considered it to be economical and wise to renew that bridge with a heavy structure, then, undoubtedly, the rule as laid down by the Interstate Commerce Commission would be applied; but if I had two miles of track, or five miles of track.

Q. Take two miles. A. Two miles of track that needed change in its entirety, to reduce grades or curvatures, and it was more economical to build a new line to do that I would treat the entire work as one proposition. I would not pick out the bridge and do one thing with that, and a hill here and do one thing with that, and a valley here and do another thing with that. I would consider the entire piece of work would come under the same scheme.

Q. Is it not true in all railroad accounting that there is a separate account kept of bridges?—A. Yes.

Q. Would you not put the new bridge into the new account?—A. Under the classification of additions and betterments; yes.

Q. What would you do with the old bridge already in that account?—A. I would give the new cost credit for the salvage.

Q. What would you do with the old bridge that is already in that bridge account?—A. I would credit it to the cost of the new work.

Q. Credit it to what?—A. As salvage to the cost of the new work.

Q. What would you do with the abandoned parts of it?—A. Well, that is a general proposition. I do not understand that I have been asked what I do with these things, but what my opinion is.

Q. I am asking you about your opinion.—A. Well, I say this again; I repeat, that I would make no separate accounting at all for the bridge proposition. I would consider the entire two miles as one proposition.

Q. Would not that result in your having, for the crossing of that stream, two bridges in your bridge account?—A. Not any more than you would have two pieces of track in your track account.

Q. Well, I understand that perfectly well; it is quite apparent to me, but I still ask the question whether or not you would not have, for the crossing of that stream, two bridges in your bridge account, if you did not take it out?—A. You would have the cost of two bridges in your bridge account, as well as the salvage of one, I think. Yes, I admit that.

Q. You admit that?—A. Yes.

Q. And you would allow it to remain there?—A. I do not say I would. I say that is my opinion.

Q. Is it your opinion that it should be left in the bridge account?—A. Under certain conditions, it is my opinion; yes.

Q. Do I understand you to take this view as to your opinion, that if a bridge, as an independent matter, is renewed for the causes named, you would charge the construction of the new bridge to the bridge account?

Mr. Wickwire. One minute—

By Mr. Needham:

Q. (Continuing.) And you would deduct from the bridge account the cost of renewing the old, less salvage; is that correct.



Mr. WICKWIRE. One moment. I object. You say the bridge is renewed for the reasons stated. Now, do you mean —

Mr. NEEDHAM. The reasons he stated.

Mr. WICKWIRE. Will you kindly specify whether the bridge is worn out and replaced by another, or whether it is designed to make a new improvement?

Mr. NEEDHAM. Where it is necessary to make the road adequate for the new traffic, to treat with this case.

Mr. WICKWIRE. In order to improve the road?

Mr. NEEDHAM. Yes.

A. Now, in my opinion, the renewal of a bridge is purely an item of maintenance, dealing with a bridge alone. It is purely a matter of maintenance, and if you renew that bridge in kind, the cost of renewal becomes a maintenance charge. If you renew it with a heavier structure, there is an element of additions and betterment.

By Mr. NEEDHAM:

Q. To what extent? A. That element is determined, as I recall it, under the rule by the increased capacity, measured in dollars and cents, of the new bridge over that of the old.

Q. Well, in your opinion, is that correct accounting, reasonable accounting? A. I think it is conservative railroading.

Q. And do you think it is correct as an accounting proposition?

A. Well, yes. I do not see anything very objectionable to it.

Q. Now, that is where you treat a bridge separately? A. Yes; simply an element of maintenance.

Q. Well, take this case again; we will come back to it in order that we may be clear and understand each other. A railroad running from A to B, as I have indicated on this paper, has in it two miles of embankment and line road, and connecting those two a bridge over a stream; that line of railroad becomes inadequate for the carrying of the traffic either because of grades, the weakness of the roadbed, which would include the bridge, or for any other cause, and to meet that demand of the traffic, instead of improving the line, a new line is built from A to B, with two miles of roadbed and a bridge connecting the two. Assuming now that the old bridge cost \$100,000, is in your bridge account, which is a part of the property account, you put the new bridge into the property account. What would you do with the old one in accounting for it in that case? A. I repeat what I have previously said, and I shall endeavor to make myself a little clearer: If the road from A to B represents two miles —

Q. Of roadbed? A. Of roadbed; and, as you put it, cost a hundred thousand dollars per mile, with a bridge in the middle, costing a hundred thousand dollars, under those conditions you would have an investment there of \$300,000 for the two miles, including the bridge. Now, it is found that, for economy and other purposes, it is best to build a straight line from A to B, cutting out the grades and curves in the old line, and the new line costs, say, \$250,000 to build, your total investment in the property would then be \$550,000, and the disposition of the costs for the new line should be dealt with in respect to the bridge without any reference whatever to the element of maintaining the old bridge, because the old bridge is abandoned or moved in a new location.

Q. You do not mean "moved." A. That frequently happens.

Q. I am not assuming that in this case. I am assuming a new bridge; therefore there is no movement.—A. Now, in this case you have an entirely new bridge. You are not adding anything to the maintenance of this old bridge, because it is torn down. There is no way you should treat this bridge one way and the line another way in this transaction. You should consider it as one scheme.

Q. What would you do with this item of \$300,000?—A. The item of \$300,000, less salvage that I got from the old line, would represent my original investment.

Q. The new line, you say, cost \$250,000?—A. Yes.

Q. Now, that, with the salvage from the old line, you would say would represent the investment in the new line?—A. Yes; \$250,000 would be the cost of the new line.

Q. Yes. Suppose the salvage was \$50,000, to use an arbitrary figure.—A. Then I would consider I had an investment of \$500,000 in the property.

Q. You would consider there was an investment of \$500,000 in the property?—A. Yes, sir.

Q. And would you allow that to remain in the property account?—A. I don't say I would.

Q. Well, what would you, in your opinion, do with it?—A. I would determine that when the case came up.

Q. Well, it has come up now.—A. Not with me.

Q. Yes; as an expert witness, it has come up with you now. What would you do with that account?—A. I would give you my opinion, sir, that the expenditure of \$250,000, less \$50,000 salvage, would represent the investment in that property of \$500,000.

Q. What would you do with the items, as an accountant?—A. If my road was very, very rich, with plenty of money, I would, possibly make one disposition of it.

Q. What disposition would you make in that case?—A. If it was a poor, struggling road, I would make another disposition of it.

Q. Tell us what you would do with it. I would like to know what you would do with it, speaking as an expert.—A. I can not tell you what I would do with it, but my opinion is that it represents your investment in that property. It represents an improvement in your property, and you should be permitted to so consider it.

Q. Does it represent the true cost of the road from A to B as existing after the change has been made?—A. As to that I will say no; it does not represent the true cost of the road, but the sum total of the two amounts does represent your investment in your property.

Q. You distinguish, then, between "cost" and "investment."—A. Yes.

Q. By "investment," you mean what the stockholder has put into it?—A. I mean the money that has been spent on the railroad, yes, sir.

Q. And you are speaking entirely with reference to investment when you justify the keeping of the abandoned property or its value in the account?—A. I do; yes.

Q. What would you do with it if you were required to consider simply the cost of the existing property after the improvement was made?—A. If I were required to consider only the cost of the property after the improvement was made, I think I would then consider that other part, that part was abandoned would be a loss to me.

Q. How would you arrive, as an accountant, at that cost that was a loss?—A. How I would determine the measure of the cost?

Q. Yes; of the loss?—A. Of the loss; yes. That would be a very difficult thing to do.

Q. Well, how would you do it?—A. Unless I knew accurately the amount at which the old line stood in my property account.

Q. If you did not know that, what would you do?—A. Well, I would do the best I could in estimating it.

Q. You would estimate the cost of reproducing the old line and deduct the salvage; is that correct?—A. If it became necessary to determine the cost of the old line, yes; I would do it by estimating, and I would deduct from it the salvage.

Q. And the balance would represent the loss to you, by reason of the abandonment?—A. Oh, no; not in every case.

Q. As to cost, I am speaking now.—A. No, well, as to cost, by "cost" do you mean the property account on your books or the actual expenditure of money?

Q. I mean the actual cost of the existing operating line after the improvement has been made.—A. Regardless of how it stands on your books?

Q. Yes; regardless of how it stands on the books.—A. Well, I would have to estimate it.

Q. And that would represent the loss?—A. Yes.

Q. And if the property account is to represent the true cost of a given road at a given time, as operating, those losses would necessarily have to come out of the property account, would they not?

A. Provided they are in there; yes.

Q. Assuming they are in there?—A. But they are not always in there.

Q. Now, I understand you to say that in a scheme such as I have outlined here, you would make no difference between the bridge and the embankment?—A. Not as to the disposition of the cost. Of course, I would classify each individual piece of way in accordance with the prescribed classifications.

Q. But in disposing of the question of cost or loss, that we have discussed, you would treat the two alike?—A. Yes; as one scheme.

MR. NEEDHAM. I think that is all.

#### Redirect examination by Mr. Wickwire:

Q. Now, taking the illustration that has been mentioned here of a portion of a road which cost \$300,000 and which was to be abandoned in connection with making grade improvements upon the new location, which would cost \$250,000, and under the circumstances where there would be a salvage of \$50,000 out of the old line, would there be a justification for making that improvement unless it could be reasonably expected that the earnings of the road would be sufficient to maintain their old earnings and also to bring in a fair return upon the added investment?—A. Well, both increased traffic and reduced operating costs are considered in connection with any scheme of enlargement or improvement of facilities.

Q. Yes.—A. Yes.

Q. What I mean is, would the improvement be justified whereby the net expenditure of \$200,000 additional would be required in this case, unless it was reasonably obvious upon the estimates made that

the road could maintain its old earnings and could get a fair return upon the added investment of \$200,000?—A. We generally figure to make those improvements pay a fair return upon their cost.

Q. Taking the case which has been presented by the evidence here of an improvement which cost something over \$600,000, and under which only \$200,000, in round numbers, may be added to the capital account; if that \$200,000 represented the total improvement to the property, would any board of directors be justified in expending \$600,000 for that purpose?

Mr. NEEDHAM. I object to that, because that is a matter of business policy. We have not anything to do with that.

Judge CARLAND. That would seem to be so.

Mr. WICKWIRE. Well, I will change the form of the question.

By Mr. WICKWIRE:

Q. In your opinion, could an expenditure of this kind be financed, that would cost \$600,000, if the net improvement to the property was worth only \$200,000, based by the return made upon it?

Mr. NEEDHAM. The same objection to that, your honor. It is a mere question of business policy. It does not determine the character of the item that is to be charged to any particular account.

Judge CARLAND. I think it is objectionable. Whether a proposition can be financed depends upon a good many considerations.

By Mr. WICKWIRE:

Q. You were asked on cross-examination as to whether, in case of an abandonment of a portion of the line incidental to a grade improvement, the cost of the property as now operated would include that abandoned portion of the line, to which I understand you answered no. Is it not a fact that there are now carried in the property accounts numerous items representing property which is not now physically present?

Mr. NEEDHAM. I do not quite understand that.

By Mr. WICKWIRE:

Q. (Continuing.) For instance, scaffolding and false work in a bridge, the cost of surveys not used, and similar items.—A. I can not answer that definitely, because I do not know what disposition has been made of these items in the railroad account; but in the natural course of events, I should say yes. The property accounts do now carry charges for things that are not really in existence.

Q. Suppose a piece of property having upon it an expensive building worth \$200,000 is purchased by a railroad company, and the company desires to use that site for some other purpose, rendering the building unnecessary, and the building is demolished and removed and the new improvement put in its place; that is another illustration, is it not, in which the present cost—

Mr. NEEDHAM. Wait a moment. I object to the form of the question. Let him say what he will do with that.

By Mr. WICKWIRE:

Q. Well, state what the regulations of the commission provide shall be done with that item.—A. Well, before the promulgation of the commission's classification of additions and betterments, I think a great many transactions of that kind possibly occurred, and the

first cost, plus the improvement, now stands in the property accounts. Under the rule of the commission, as promulgated in its classification of additions and betterments, the cost to rebuild the old building in kind would have to be deducted from the cost of the new building.

Q. I am referring to a case not in which property was previously devoted to a public use, but where entirely new property is acquired, which has been previously used for some other purpose. A. Well, in that case, I should think the cost of your new structure would represent an additional investment to you, and you would be justified in putting the whole cost against your property account.

Q. And in that case the cost of the property would represent the cost of the original building which was torn down, although it was no longer physically in evidence? A. Yes. If you buy property for a specific purpose and there is a building on that property which it becomes necessary for you to tear down and replace with another structure, the original cost of the property, plus the cost of your new building, less whatever salvage you may get from the old building, would certainly be a proper charge to your property account. It would represent your investment in the property.

Mr. Wickwire. That is all.

Recross examination by Mr. NEEDHAM:

Q. I notice in that illustration you use the word "investment," while counsel used the word "cost." If the ground was worth \$25,000 and the building on it was worth \$50,000, and you tore down the building and put up an office building for a railroad on it that cost a hundred thousand dollars, what would be, in your opinion, the cost of the present property? A. \$175,000, less the salvage that you would get from the old building.

Q. Less the salvage that you would get from the old building? A. Yes.

Q. You would put it in as cost, would you, not as investment? A. A. Well, that would be your cost and investment, too.

Q. Now, you are treating the question of cost and investment as the same? A. Yes, sir; the same thing.

Q. Would that be a truthful statement of the cost of the building? A. The cost of the building?

Q. Yes; the present building? A. No.

Q. No; it would not? A. It would include your real estate as well.

Q. Well, if you would include the price, which I have estimated at \$25,000? A. Yes.

Q. The old building, which cost \$50,000, would not be there, would it? A. Yes; but you had to buy in order to get your site; so, therefore, your site cost you \$75,000.

Q. Not at all. My site cost me \$25,000 and the building on it was \$50,000; that is \$75,000. Now, I am not contented with the building; I want a better building on it. A. Yes; you tear down the old building.

Q. I tear down the old building and I put up a new building that cost me \$100,000. A. Yes.

Q. (Continuing.) On that site. Called upon now to state the cost, not the investment, but the cost of the present property as it stands, what is the cost of the present property as it stands, assuming that the

site is worth just what it was worth before?—A. I do not see how you can make any such assumption when, as a matter of fact, you pay \$75,000 for your site, upon which there was a building valued at \$50,000.

Q. It cost me \$50,000; I do not say valued.—A. Well, it cost you \$50,000. You destroyed the building; you have only the site left. That site certainly cost you \$75,000. That is your investment in the site.

Q. I am talking about the cost now, not the investment. Please do not use that word. I want your statement in regard to using the word "cost."—A. Yes.

Q. I will give you another illustration, please. A railroad has a bridge across a stream, with piers, a steel bridge standing on stone piers. The stone piers have cost \$50,000; the steel bridge cost \$100,000. By reason of the increase of traffic, of the necessary increase of the weight of equipment, it becomes necessary to put a new bridge over that stream, the old bridge being good for the purposes for which it was built, but not sufficient to carry the new equipment and traffic. A new bridge is put across that stream upon the old piers, they being sufficient; the piers cost \$50,000. A new bridge is built at a cost of \$85,000, the materials being cheaper than when the old bridge was built, sufficient to carry the traffic. What would that bridge cost—not what the investment is—but what would that bridge as it stands there cost?—A. It costs you the cost of the old plus the cost of the new.

Q. You say now that you would put that into the property account?—A. Under the conditions cited by you, my personal opinion is that the \$85,000 would be an additions and betterments charge. That is my personal view of it.

Q. It would be what charge?—A. A charge against additions and betterments.

Q. It is a new bridge?—A. There is a bridge—

Q. What would you do with the old one?—A. That did not need repairing.

Q. Yes; but it was not sufficient to carry the new equipment and the new traffic.—A. Yes; but it did not need repairing. It is perfectly good, possibly, for years to come, for present purposes; but to meet the increased traffic a stronger bridge had to be put in. I would say the cost of the stronger bridge, less the salvage from the old, under those conditions, where no element of maintenance was required or entered into that, the addition should be charged to additions and betterments.

Q. Assuming, now, that there is no salvage.—A. I can not assume that, because there is bound to be salvage if you put in a new structure.

Q. If you were, to use your own phrase, to have a salvage of \$5,000 for the old material scrapped—I am using an arbitrary figure—would you, on your theory, then have in the property account, as representing that bridge over that stream \$95,000 for the old bridge, \$50,000 for the piers, and \$85,000 for the new bridge? You say that is a correct statement of the cost of the bridge as existing?—A. Yes.

MR. NEEDHAM. That is all.

By MR. DENISON :

Q. In the case of a lot with the building that was spoken of on it, if a railroad buys a lot with a building on it, with the purpose of destroying the building immediately, and putting up some new structure, that means that they consider that they are buying only the land, does it not?—A. Well, not necessarily.

Q. Aside from the scrap, I mean.—A. They buy the property for their own purposes.

Q. Well, all the purpose they have in mind is the use of the land?

A. Not in every case.

Q. Well, the case I suppose.—A. Yes.

Q. Now, I am supposing a case where all the railroad wants is a site for a new building.—A. Yes.

Q. It looks around and it finds a piece of land with an old building on it.—A. Yes.

Q. And having no use for the old building, but needing only the land, it buys the whole thing. Now, what it is paying for is exclusively the land, is it not, aside from any question of scrap value of the building?—A. Well, in fact it pays for everything it gets.

Q. All that it wants, and the only thing it calculates the worth of is the land, is it not?—A. That is generally the case; yes, under the conditions, cited by you.

Q. And the railroad, if it is acting with proper economy, will not buy such a property, wanting only the land, and pay more for it than it thinks the land alone is worth to it?—A. Well, they have to do it in a great many cases.

Q. Why does a railroad have to pay any more for a thing than it thinks it worth to it?—A. That is not your proposition.

Q. That was my proposition.—A. Take the Pennsylvania line entering New York—

Q. Yes.—A. Do you mean to tell me the only thing they paid for the right of way in there was the value of the land, regardless of the value of the buildings?

Q. If they paid the value of the land and anything more, they paid more than they were justified in paying, did they not?—A. I am sorry to say I can't see it that way.

Q. I am sure the only asset they acquired is the land, is it not, and what they paid is what they had to pay for that asset?—A. Yes.

Q. For the land exclusively.—A. But they certainly paid more, I should imagine, for the land and buildings than the value of the land alone.

MR. DENISON. That is all.

By MR. NEEDHAM :

Q. Mr. Plant, I can not harmonize your statement in the first cross-examination and in the last, and I want to be sure I am right; that is all. Would you make a distinction between the instance which I gave you and the instance where the bridge was built on a different site, with reference to deducting from the property account the cost value of the old?—A. Where the bridge was built on a different site?

Q. Yes. Would you make any distinction between the case where the renewal was on the old site and where it was a renewal on a new site, the line being changed, of course?—A. In the case of the construction of the bridge in connection with the scheme of changing the grade and alignment, I would make no distinction between the bridge and the other part of the line.

Q. I understand that; I am not getting back to that. You said with reference to this illustration which I gave, for instance, when they built the bridge upon the old piers—A. Yes.

Q. That you would retain in the property account the cost of the old, less salvage, and the cost of the new and the cost of the piers. Now, I understood you in cross-examination before to say that where there was a renewal of a bridge, that you would deduct from the property account the old bridge, less the cost of reconstructing the old bridge, and you would arrive at the cost in the best way possible. Now, you say, in answer to my last question, that you would not deduct anything. Is that your answer?—A. No; you did not clearly understand my answer.

Q. Well, I want to; I want to get your position clearly.—A. Yes; if you will pardon me, there are two elements in the illustration I used. One is where it becomes necessary to renew a bridge because it has worn out; it has reached a point beyond which we can not economically repair it; we have got to renew it with a bridge. Now, if we renew it in kind, the entire cost, less salvage, becomes a charge to operating expenses and of maintenance. Your property account is not affected at all.

Q. What do you do with the old bridge? It is in the property account.—A. Well, it stays in the property account. I say the entire cost of the new bridge, if it is renewed in kind, becomes a charge to operating expenses through maintenance. Your property account is not affected at all.

Q. Yes.—A. Now, there is another case. Assuming a bridge has worn out and it becomes necessary to renew; you decide to renew it with a stronger, heavier structure, to carry heavier loads. Now, in that case you have an element of additions and betterments. That element is measured by the cost of the new, less the cost to rebuild the old in kind. That addition to your property is charged to additions and betterments. The rule provides for that. Now, there are two separate and distinct cases; one, where strictly for maintenance purposes you renew a bridge in kind; under that condition you have no additions and betterments. The other is where you put an improved structure there, a heavier structure there, and you have additions and betterments in that case. Now, the third case cited by you was where you have a bridge that does not need renewing. It needs no maintenance work. It stands there ready to meet the demands of ordinary traffic, but you find it necessary to throw over that railroad a greatly increased traffic, necessitating the use of much heavier power. You find that this bridge is too light for the increased weight of the power. Therefore you construct an eighty-five thousand dollar additional investment on it. Now, I claim that—

Q. A new bridge.—A. Yes; a new bridge, with a cost to you of eighty-five thousand dollars. Now, my own personal opinion there is that the additional cost to you of eighty-five thousand dollars, less



what you can get for the old bridge, should be considered as additions and betterments to that property.

Q. Without deducting anything for the old bridge?—A. No; I say less scrap.

Q. I mean, except the salvage.—A. Yes.

Q. But not deducting anything out of the property account?—A. Not one cent.

Q. On account of discarding the old bridge?—A. No, sir; that is my personal opinion, sir.

Q. What would you do with an engine that was in good repairable condition but too light for your use, and in order to move the trains you are moving to-day you can not use it, and you have to buy another to take its place. What becomes, in the accounts of that old engine, which is scrapped?—A. My personal view in regard to a property that is movable property, similar to the case cited, namely, an engine or a car, and all property of that character—my personal view is that the classification promulgated by the Interstate Commerce Commission with respect to renewals and abandonments is proper. It is entirely different from conditions existing with respect to fixed property, such as your roadway.

Q. You make a distinction between movable property or equipment—A. I do.

Q. (Continuing.) And permanent fixtures?—A. I do; and I think every time an engine is repaired or goes out of service that the equipment account should be credited with the value of that engine.

Q. Does that method of treating accounts prevail on all the roads of the country?—A. I wish I occupied a position to be able to say that, sir.

Q. Can you answer it at all? Have you any knowledge that will enable you to answer that question?—A. Whether the rules of the commission are observed by all railroads?

Q. No; I did not ask you that. I am asking you the question now as an expert accountant. You have just stated that you would treat abandonments of movable property differently from abandonment of bridges and roadbed. Is that the way the accounts are treated by the railroads of this country?—A. I do not know.

Q. Do you know anything about that, outside of your own road?—A. I have only had experience on one road.

Q. Do you know anything about it, as a matter of fact, Mr. Plant?—A. I think the rule is generally observed; the rules of the commission are generally observed, sir; on all railroads. That is my candid opinion.

Q. Is it not a fact, that, before the rules of the commission were promulgated, there were roads that were following exactly the same practice in this country?—A. Oh, yes; but I think there are very few of them that were following the rule with respect to the abandonment of roadway property.

Q. There were some, were there not?—A. There were some, I daresay; yes.

Q. It was the practice among some?—A. Yes; I would say so.

Q. Is not your position, Mr. Plant, practically the English position of adding all investments to property account and capitalizing it?—

A. No.

Q. I want to know, as applied now to roadbed fixtures, whether your position is not exactly the position of the English system?—A. No, sir; it is not.

Q. It is not?—A. No, sir.

Q. As distinguished from the American theory of treating abandoned property. Don't you know, as a matter of fact, that all investments in the English system are capitalized?—A. Yes.

Q. As investments, now I mean.—A. I know also, that is, it is my opinion, that the English people capitalize a great many things that, under the rule, we have to charge to operating expenses.

Q. There is a difference between the practice there and here?—A. Yes.

Q. For example, I ask you whether your theory of treating an abandoned property, which was a part of roadbed and fixtures, is not practically the English system?—A. Well, I do not know that it is. I can not say that it is.

Q. Wherein does it differ?—A. I can not say that it is.

Q. Wherein does it differ? You say everything should go in. That is what they say.—A. I am not sufficiently familiar with the English practice to say that it is the same. I do not think I would be as drastic even if I did carry out my own views about disposing of those things. I do not believe I would be as drastic as I understand the English are with respect to charges for additions and betterments.

Q. I will ask you just one other question: Would you treat a case of a wash-out, where a bridge was destroyed and had to be renewed, any differently than in the instance I have given you?—A. That would be purely maintenance. It would be charged to operating expenses.

Q. And would be charged to operating expenses?—A. To operating expenses; yes, sir. It is an incident of operation.

Q. On what theory?—A. Because the property is damaged, and you have to replace it, just the same as if you had a collision of two locomotives. The replacing of those locomotives would be an operating cost.

Q. Then you do treat in that respect fixtures just the same as you would treat locomotives?—A. Yes; that is true of the maintenance entirely.

Q. Suppose you were renewing that bridge after it had been swept away, and you anticipated heavier traffic in years to come, and should make the strength of the bridge fifty per cent more than the old bridge, what would you do with it then?—A. In practice, I would apply the rule of the Interstate Commerce Commission.

Q. You would stick by the commission in that case?—A. Yes, sir.

By MR. DENISON:

Q. Is that because that is ordered, or because of your own opinion? I mean irrespective of its having directed that, would you do it?—A. Well, take the case I cited a moment ago. You get that element of maintenance, and in doing that maintenance you put it stronger than you had it before.

Q. You mean the rule of the commission is correct in that respect?—A. I think in that respect the rule of the commission is correct; yes, sir.

By Mr. NEEDHAM:

Q. Suppose the bridge that was there, and which was swept away by the freshet cost one hundred thousand dollars, and was practically new, and you replaced that with a bridge capable of carrying a traffic fifty per cent heavier, and that bridge cost you one hundred and twenty-five thousand dollars. I will assume you could have replaced the old bridge for one hundred thousand dollars, but you replaced it by a bridge costing one hundred and twenty-five thousand dollars. What would you do with the items?—A. That would be a very unusual condition, sir. In that case my additions and betterments would be \$25,000.

Q. You would charge to additions and betterments \$25,000, and you would charge to operating expenses \$160,000?—A. Yes; the increased value of the bridge would go to additions and betterments.

Q. What would be your treatment of an embankment that was swept away?—A. It would be charged to maintenance. It would be a maintenance charge.

Q. You would treat the two, the embankment and the bridge, exactly alike?—A. If they were destroyed by a flood or any other casualty: yes.

Q. Suppose that bridge had been there for ten years, but was good for the purposes intended, and it cost \$100,000 and was swept away by a flood, and you renewed it by a bridge that was capable of carrying fifty per cent more weight. Owing to a change in the price of materials, it only cost you \$95,000. What would you do with that?—A. The cost of the new had increased—

Q. Yes; fifty per cent increase in carrying power, at a cost of \$95,000.—A. I would have to credit operating expenses with the brand new bridge.

Q. You would charge it all in that case to operating expenses, would you?—A. Yes.

Q. Because it cost less than the old bridge cost ten years before?—A. Yes. The bridge was swept away by flood, and I had to renew it—

Q. Yes.—A. But I renewed it at a less cost than the old bridge.

Q. That is, you renewed it by putting in a heavier bridge that would carry fifty per cent more weight, because of prospective future traffic, and it only cost you \$95,000?—A. Well, there might be an addition and betterment along there, sir. That is a rather unusual condition. I would have to think about that a little bit.

Q. How long do you want to think about it?—A. Well, until to-morrow, probably, but it seems to me I would renew the old bridge and operate the entire cost to operating expenses.

Q. Why do you make a difference between being compelled to renew—I mean a difference in your accounts—of being compelled to renew by reason of a sudden accident and by reason of wear and tear?—A. I do not.

Q. Do you treat them alike?—A. Yes.

Q. Why do you make a difference between a sudden accident and wear and tear and a bridge that has become inadequate to carry the traffic?—A. In the case of a bridge that has become inadequate to carry the traffic, as you and I have been talking about, there is absolutely no maintenance entering into the transaction. It is supposed

that the bridge is in condition to meet the existing traffic, but it has to be strengthened to meet a materially larger traffic, and, under those conditions, you certainly, in strengthening that bridge, have an element of additions and betterments. Let me put it a little differently, if you will pardon me a moment.

Q. Go ahead.—A. Here is one bridge that is in perfect condition. It meets all the conditions of the traffic. It becomes necessary to double your traffic. To meet the requirements, you build a second bridge right alongside, and extend a double track on your railroad. That would certainly be an addition and betterment. Now, instead of building a double bridge, you strengthen the old by putting in a new structure——

Q. No; I do not strengthen the old because the old has gone.—A. But you would put it on the same old piers.

Q. Yes; but I mean a new bridge. You cannot call that strengthening the old.—A. You would strengthen the structure that carries you over the stream, or, in other words, you build a new bridge over the stream, as you put it.

Q. Yes. Under your illustration, the two bridges, under the rule of the Interstate Commerce Commission, would be charged to betterments, property account?—A. The second bridge; yes.

Q. The second bridge, and the first one being in that would not be taken out, of course.—A. Yes.

Q. And both bridges would be in the account?—A. Yes.

Q. Suppose, instead of building a second bridge, you did what they did at Poughkeepsie, crossing the Hudson River, you strengthened the old bridge, without taking it down, but by adding material to it and thereby strengthened it so that it would carry a heavier traffic. Under the rules of the commission you could add the whole of that cost, could you not, because the bridge as it stands represents the old bridge and the additions?—A. Yes.

Q. Now, when you tear that bridge down for any cause that is sufficient to induce you to take it down, and substitute an entirely new structure in its place?—A. To meet those conditions?

Q. To meet those conditions.—A. Yes.

Q. Can you say that the new bridge has cost you the expense of putting in the new bridge, less salvage, and the cost of the old one?—A. Yes; my personal opinion is that the cost of the new bridge, less the salvage for the old, should be a charge to the property account as additions and betterments.

Q. And you would capitalize the two bridges?—A. I would do so unhesitatingly.

MR. NEEDHAM. That is all.

MR. WICKWIRE. That is all. Call Mr. McCarty.

RICHARD J. McCARTY was called as a witness on behalf of the petitioners, and, being first duly sworn, testified as follows:

Direct examination by MR. WICKWIRE:

Q. Will you state your full name?—A. Richard J. McCarty.

Q. Where do you reside?—A. Kansas City, Mo.

Q. What is your occupation?—A. Vice president and auditor of the Kansas City Southern Railway Company.

Q. How long have you occupied that position?—A. I was auditor of the Kansas City Southern Railway Company when it was incorporated in March, 1900. I remained auditor until 1903. I then severed my connection with the company until 1905, when I was reappointed, and in 1906 or 1907, I have forgotten now which, I was appointed vice president, in addition to being auditor.

Q. You have been in charge of the accounts of this railway company during this period that you have mentioned?—A. Yes, sir.

Q. Will you state what your experience as an accountant was prior to the time you went with this railroad?—A. I was appointed auditor of the Kansas City, Pittsburgh & Gulf Railroad Company, which was the predecessor of the Kansas City Southern; that is, the company that owned part of the track that the Kansas City Southern took over when it was organized. I was appointed auditor of the Kansas City, Pittsburgh & Gulf in November, 1897, and remained as the auditor of that company until April, 1899, when it went into the hands of receivers. I was then auditor for the receivers, until the property was taken over by the Kansas City Southern.

Q. Will you state what your prior railroad experience was?—A. Previous to that time, from June, 1888, until June, 1895, I was general manager and chief engineer of the Metropolitan Street Railway Company of Kansas City; and from 1895 until 1897 I was practicing civil and mechanical engineering.

Q. Are you a civil engineer as well as an accountant?—A. Yes, sir.

Q. Have you the figures showing the actual amount expended upon the six sections of the lines involved in this case?—A. Yes, sir.

Q. Can you state what the total expenditure was?—A. The total actual expenditure to October 31, 1912—I have it here under two separate heads—the value of the old material used was \$91,685. That is the value of the material that was taken out of the abandoned track and used in the new, and all other costs were \$767,159.81.

By Mr. DENISON:

Q. You say up to October 31, 1912. It has not yet been completed?—A. Well, I presume it is, practically, but in a work of that kind there are continually little charges drifting in, for a long time afterwards.

Q. But you have said that this represents substantially the final cost?—A. Yes; I think it is practically correct. There may be a few hundred dollars more to drift in yet, but they will be inconsequential.

By Mr. WICKWIRE:

Q. Are you familiar with the issues involved in this case?—A. Yes, sir.

Q. Will you state whether, in your opinion, the estimated replacement cost of the portions of the line abandoned, as set forth in the petition in connection with grade reduction, are properly chargeable against operating expenses?—A. I do not think they are.

Q. Will you state whether, in your opinion, the cost of the grade reductions made off the line of the road, less the salvage obtained from the former location, should be charged to the capital account?—A. I think the total amount expended should be charged to capital account.

Q. Will you state the reason for your opinion in respect to these matters?—A. The principal reason is that this additional money was expended with a view to increase the net revenues, which it was estimated would yield a fair return upon the additional investment, and therefore increase the value of that property by that amount. Otherwise, there would not have been any justification in expending the money. Do I make myself understood?

Q. You understand, do you not, that where a grade reduction is made upon the line of the present railroad, the regulations permit the company to charge substantially the entire expenditure to additions and betterments?—A. Yes.

Q. Do you know of any reason for the distinction between the requirement in case the grade is revised upon the present right of way or upon some adjacent ground, provided the purpose, in either event, is simply to obtain reduced grades, and provided the railroad has ultimately improved this between the same termini and serves substantially the same territory?—A. Well, if the improvement is made with a view to increasing the net revenue, there is no reason why there should be any distinction at all. Of course there might be occasions when a thing of that kind might be done for some other purpose. That would be a different question. It depends entirely upon the occasion and the object in view.

Q. If the reason was the same in either case, do you know of any reason for the application of a different rule of accounting?—A. If the reason is for an increase in net revenue, then the old property ought to be allowed to remain in the capital account, for the reason that the expenditure could never be justified unless it would enable the company to earn a reasonable return upon the additional investment.

Mr. WICKWIRE. You may cross examine.

Cross-examination by Mr. DENISON:

Q. Were the six pieces of line that were abandoned covered by some mortgage prior to the improvements?—A. Yes, sir.

Q. And the new pieces of line, are they covered by any mortgage?—A. Yes, sir.

Q. By the original mortgage, that extended to after-acquired property?—A. Yes, sir.

Q. They are also covered by the mortgage issued on the raising of the money for the improvement, are they not, the second mortgage?—A. Yes, sir.

Q. Now, is it not true that the physical security lying behind these two mortgages has been depreciated to the extent of the abandoned six pieces of line?—A. I do not think so.

Q. I say the physical security is less by reason of those six pieces of line, is it not?—A. I do not think so.

Q. Why not?—Because the improvements will earn a reasonable return on the investment.

Q. But aside from that question of the theory of values, as you people claim it, is it not a fact that there are six physical things which no longer exist as security under those mortgages?—A. There are six physical things, as you say, that no longer have physical existence.

Q. Yes.—A. But in the place of it you have six other physical things which will earn an amount of additional net revenue, which

increases the security, because the value of all securities depends not upon the cost, but upon what the property can earn.

Q. But those six new things have been paid for by money raised on the new mortgage.—A. Do you mean the old—

Q. The six new things were built out of the proceeds of the sale of new bonds?—A. Yes; that is right.

Mr. DENISON. That is all.

By Mr. NEEDHAM:

Q. You stated on direct examination that if the reason for the improvement was to secure increased net revenue you thought the whole investment should be retained in property account?—A. Yes, sir.

Q. Suppose the purpose of a given classification is to represent the actual cost of the existing property.—A. Yes, sir.

Q. After the improvement has been made, what would you say then with reference to the propriety of leaving the full value of the abandoned property in the property account?—A. I would provide for that in this way: I would carry the visible property in an account, showing, as you say, the cost of it. I would then carry, right underneath that, as a deferred debit item, the value of this abandoned property, upon which, under the circumstances, the company would have a right to earn a fair and reasonable return. I would not deceive anybody at all.

Q. You would not treat it, then, as part of the cost of the new road, but you would treat it as an investment upon which they would have the right in the future to earn.—A. A reasonable return.

Q. A reasonable return?—A. Yes, sir; that is my idea. I agree with you that it should not be merged in and thrown in. There ought to be a distinction there.

Q. And you make that distinction by making the two entries you have?—A. Showing the two items on the balance sheet, but, in my judgment, I think that if it is something that the company has a right to earn a reasonable return upon, it ought to be carried in some way or other on its balance sheet, and not written off to the cost.

Q. Suppose it should be determined by some power, outside of yourself, that the item which you have called a deferred item should not be carried in that way, what would you charge it off to?—A. Well, I expect I would have to charge it off to the same account as this authority which you are talking about tells me to charge it off to.

Q. Assuming now that the authority should ask your advice as to where it ought to be charged, and assuming that it can not remain as a deferred item, as an expert accountant, what would you say?—

A. Well, I should say it certainly should not be charged to the current cost of operation. If it had to be charged up in any way against the earnings of the company, it ought to be charged to profit and loss.

Q. Profit and loss represents, of course, the balances each year?—A. Profit and loss represents the net income of the company less taxes and fixed charges.

Q. It is the balance of the balance sheet?—A. No; it is not necessarily the balance of the balance sheet. It represents the earned surplus.

Q. Very well, put it that way.—A. What is available after discharging all of its obligations.



Q. And remains there in the balance?—A. Yes.

Q. Now, that balance is decreased in a given year if such an item as this were charged to operating expenses?—A. Yes.

Q. That is, if you charged this \$500,000 approximately to operating expenses it would reduce the balance of operating expense; that is the balance of expense as against revenue, and that would reduce that much the profit and loss balance at the end of that year, would it not?—A. Well, that is what is known as income account. It would reduce the net income for that year.

Q. Yes.—A. There is a definition of profit and loss as being an accumulated surplus for a series of years.

Q. What I am getting at is how would that affect a company at the end of a given year, say at the end of the present year. You are called upon on the last day of December to enter that account. Now, if you charged it to profit and loss on the thirty-first day of December, what is the difference in the final results on that day at the end of the year, and what would be the difference if you had charged it to operating expenses?—A. There might be a very great difference in this way—

Q. Will you explain it?—A. For instance, you take it on the Kansas City Southern; the Kansas City Southern pays 4 per cent noncumulative dividends on its stock. That dividend can not be declared unless it is earned during some fiscal year. Now, if, according to these regulations, this \$500,000 should be charged to the income account it would cause the company to pass the dividend during that year, and it would be very disastrous to the company, to its creditors and stockholders and everybody concerned; whereas, to charge the \$500,000 to profit and loss would simply mean to charge it as against the surplus that had accumulated in previous years over and above what the company had paid out. That is one of the principal differences.

Q. That is peculiar to your company?—A. Well, I do not see that it is peculiar. It is a fact so far as the Kansas City Southern is concerned, and I presume it is a fact in connection with many other roads that have such preferred stock dividends.

Q. Suppose that that \$500,000 were divided into partial payments sufficiently low so that the charge to the present year would not prevent the payment of the interest on the preferred stock, and the balance was scattered over a period of years, what would be the difference in the result of your account?—A. The difference is precisely the same.

Q. I say, what would be the difference to your company whether it was charged to operating expenses in that case or to profit and loss?—A. It would depend upon whether that would cost the company its dividends.

Q. Assuming now that it would be reduced to partial payments, so that it would not have that effect?—A. It would then have this effect, that, as I understand it, the operating expenses of a railroad include all items that are necessary to keep that railroad in good physical condition constantly, and should not include any other charges. These charges that would come in, as you say, on account of abandoned property have no connection whatever with actual cost of operation and maintenance of that property, and it would make the income account show a result different from what had actually been



achieved by the company. I am proceeding upon the theory that I have been forced to charge these either into operating expenses or profit and loss.

Q. But in one case the profit and loss account would be reduced and in the other case the operating expenses would be reduced; that is, if it is charged to profit and loss, as you state, then profit and loss at the end of the year should be so much less?—A. So much less. The income account would show just what the company had accomplished and achieved during the year by reason of its operations.

Q. And would not the income account show exactly what it had earned during the year in case of charging this to the operating expense?—A. I am talking about net income.

Q. But the full income is shown, is it not?—A. The earnings; but it is the net income that counts, Doctor. It is not the gross at all. It is the balance you have left over after you pay all these expenses that has any significance at all.

Q. Suppose the law required you to keep a depreciation account in order to properly state the cost value—I am speaking of cost value now—on your road equivalent, assume, to ten per cent. What would you do with that in your accounts?

Mr. WICKWIRE. I object to that as immaterial and as not involved in this case.

Mr. NEEDHAM. It is a mere test of how he would keep a depreciation account.

Judge CARLAND. The objection is overruled.

Mr. WICKWIRE. I note an exception.

A. I treated this like I had been forced to treat it.

By Mr. NEEDHAM:

Q. I am asking you now as an expert accountant.—A. Yes, sir.

Q. What would you do with a depreciation account charge?—A. Do you mean account of roadbed and bridges?

Q. Yes.—A. Well, as I say, I do not believe that depreciation charges against property of that kind are proper; and if I were compelled to do it, I would ask the authority that compelled me to do it to tell me just exactly how they wanted it done, and then I would do it that way.

Q. You would comply with the authority?—A. I would waive my own discretion about it entirely.

Q. Do I understand you to take the position that, if you had such an item to deal with, you would have no judgment as to where it ought to be charged?—A. Yes, sir; I would have some judgment as to where it ought to be charged.

Q. I mean, would you charge it according to your judgment as an accountant?—A. If I had to deal with it, if I had a depreciation charge to make; I mean, if I were compelled to make a depreciation charge, then I would yield all judgment about the matter, because my fundamental judgment would be overruled. But I do not believe any depreciation charge of property of that kind ought to be made.

Q. Then I understand you would decide that if such a charge were required—A. Yes, sir.

Q. You would have no judgment as to where, as an accountant, it ought to be charged out?—A. Being, in my judgment, an improper

charge. I would say to the authority that compelled me to do it— I would have to be instructed as to how to do it.

Q. And you would not have any judgment yourself as to where it ought to be charged?—A. No; when my judgment taught me that the whole thing was improper. Of course not. I would be out under authority. All discretion had been taken away from me.

Q. In your accounts have you had to deal with a depreciation account at all?—A. There are some regulations for depreciation in operating expenses, but they have never been definite. They have never stated exactly how they wanted the charges made, and they have left the amount of the depreciation to my discretion. My discretion is that there should not be any.

Q. So you have not any item to deal with?—A. I have exercised such discretion as was given to me. Now, if they do not want me to do that, they must tell me how to do it.

MR. NEEDHAM. That is all.

THE WITNESS. You can not give a man discretion over a thing and then tell him what to do at the same time. It is either one or the other.

MR. NEEDHAM. That is all.

JUDGE CARLAND. We will adjourn now until to-morrow morning at ten-thirty o'clock.

Whereupon, at 4:40 o'clock p. m., the hearing was adjourned until to-morrow, Wednesday, December 11, 1912, at ten-thirty o'clock a. m.

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WASHINGTON, D. C.,

*Wednesday, December 11, 1912—10:30 o'clock a. m.*

Pursuant to adjournment, the court convened at 10:30 o'clock a. m.

Present: Judge Carland.

Appearances: Mr. Wickwire for the petitioner; Mr. Denison for the respondent; Mr. Needham for the intervening respondent.

RICHARD J. McCARTY, the witness on the stand at the time of adjournment on yesterday evening, resumed the witness stand, and testified further, as follows:

Redirect examination (continued) by Mr. Wickwire:

Q. Mr. McCarty, have you the figures showing the net earnings of the railway company for the year ended June 30th, 1912?—A. I have, but I very carelessly left them at the hotel, and I have just sent for them.

Q. I show you the annual report of the company for the fiscal year ended June 30th, 1912. Will you refer to that and answer this question?—A. What is the question?

Q. Have you the figures showing the net earnings of the railway company for the fiscal year ended June 30th, 1912?—A. Yes, sir.

By MR. NEEDHAM:

Q. Is that different from the report made to the Interstate Commerce Commission?—A. It is different in form, but not in substance.

Q. The substance is the same?—A. Yes, sir.

Q. You are not contradicting the reports which you have made to the Interstate Commerce Commission?—A. Not at all; no, sir.

Q. You have simply rearranged them in different form?—A. That is all.

Q. Is that printed?—A. Yes, sir.

Do you mean the net earnings or the net income, Mr. Wickwire?

By Mr. WICKWIRE:

Q. I mean the net income.—A. The net income for the year was \$885,950.16.

Q. What was the amount of the preferred dividend?—A. \$840,000.

Q. Leaving a net income, after payment of the preferred dividend, of how much?—A. \$45,950.16.

By Mr. DENISON:

Q. That is the fiscal year ended June 30th, 1912?—A. Yes, sir.

Mr. WICKWIRE. Mr. Needham, have you the correspondence which was called for at a prior time?

Mr. NEEDHAM. Yes; here it is.

Mr. WICKWIRE. Will it be admitted upon the record that this is an accurate copy of the correspondence between Mr. McCarty and the other representatives of the railway company, and the commission and Mr. Adams?

Mr. NEEDHAM. It does not need any admission. It is certified, and you have a right under the statute to introduce certified copies of anything of that kind. There is no objection to it, your honor.

Mr. WICKWIRE. Then I offer in evidence this certified copy of the correspondence between Mr. McCarty and other representatives of the railway company, and the Interstate Commerce Commission and Mr. Adams.

The correspondence referred to was thereupon marked "Petitioner's Exhibit No. 10," and is filed herewith.

Mr. WICKWIRE. That is all.

#### PETITIONER'S EXHIBIT No. 10.

I, John H. Marble, secretary of the Interstate Commerce Commission, do hereby certify that the papers hereto attached are true copies of certain correspondence had between the Interstate Commerce Commission and the officials of the Kansas City Southern Railway Company relating to the accounting for abandoned property of said railway company, the originals or press copies of which are now on file and of record in the office of said commission, and that the pamphlet attached is an official publication issued by said commission in accordance with section 20 of the act to regulate commerce, entitled "Classification of expenditures for additions and betterments as prescribed by the Interstate Commerce Commission for steam roads," effective July 1, 1909.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the commission, this 5th day of March, 1912.

[SEAL.]

JOHN H. MARBLE, *Secretary*.

NOTE.—Pamphlet "Classification of Expenditures for Additions and Betterments &c. First issue. Effective July 1, 1909. (G. P. O. 1909" not printed.

THE KANSAS CITY SOUTHERN RY. CO.,

*Kansas City, Mo., October 5, 1909.*

Hon. MARTIN A. KNAPE,

*Chairman Interstate Commerce Commission, Washington, D. C.*

DEAR SIR: The Kansas City Southern Railway Company has recently begun to make extensive improvements with a view to increasing the efficiency of its property, and is seriously embarrassed by the regulations of the Interstate Com-

merce Commission prescribing the form of general balance sheet and classification of expenditures for additions and betterments, effective July 1, 1909.

Enclosed please find copy of a discussion of the "Regulations of the Interstate Commerce Commission concerning the accounts of steam roads, effective July 1, 1909," which was prepared with a view to setting forth the embarrassing features of the regulations in question, and which is respectfully submitted for the consideration of the honorable commission with the request that the regulations be so modified as to remove the objectionable features pointed out.

One of the most embarrassing features of the regulations in question is encountered in certain extensive improvements of grade and alignment which the Kansas City Southern Railway Company has recently begun.

The occasion for making these improvements is due to several conditions, some of which apply particularly to the Kansas City Southern Railway, and some of which naturally apply to almost every carrier. The most important of which conditions may be stated as follows:

1. Construction of the road by the Kansas City, Pittsburg & Gulf Railroad Company and its affiliated companies, was begun in 1893, and it was placed in operation in September, 1897.

2. On account of the general financial depression due to the panic of 1893, it was not possible to provide funds sufficient for building and equipping the road even according to the inferior standards of that period.

3. Therefore, the road in fact and of necessity was originally located and constructed not so much with respect to efficiency and economy of operation under large volumes of traffic, as with a view to providing at the least possible expense a railroad property capable of handling the limited amount of traffic then available.

4. Thus, when placed in operation, the property was in many important respects a temporary structure, the completion of which was to be determined by future developments and conditions which could not be foreseen.

5. The development of the territory traversed by the road, naturally made possible by the road itself, and the improvement of commercial conditions in general have made available a volume of traffic which now requires both in the interest of the public and in the interest of the company the highest standards of efficiency.

Accordingly, at a great expense the whole situation was thoroughly and systematically investigated, plans were made, estimates prepared, certain improvements determined upon, the necessary funds were provided, and work was begun. All prior to July 1, 1909.

The improvements of grade and alignment mentioned involve the construction of 29.10 miles of new main track, at a cost of about \$1,200,000.00 and the abandonment of 29.10 miles of present track which it is estimated can be replaced for \$723,000.00, the estimated salvage being \$113,000.00.

According to the regulations under discussion, the Kansas City Southern Railway Company, is required to credit to its "capital account" the sum of \$723,000.00, the estimated cost of replacing the abandoned tracks, charge into its "current assets" the salvage of \$113,000.00 and to charge to its "operating expenses" the difference between the cost of replacing the abandoned track and the salvage, or the sum of \$610,000.00.

The improvements in question were undertaken upon the basis of estimates which shows that under the present conditions the net returns resulting from increased earnings and decreased expenses would be about 6% per annum upon the capital invested in the new tracks, or a total of about \$72,000.00 per annum.

To charge the \$610,000.00 mentioned to operating expenses in equal amounts for the next ten years would show during that period a net return of only \$11,000.00 per annum from an investment of \$1,200,000.00 whereas, *and as a matter of right*, the Kansas City Southern Railway Company *should show from the start the actual increase in net earnings resulting from the improvements in question.*

Hoping to receive at an early date advice of the favorable action of the commission upon this important matter, and with assurance that the Kansas City Southern Railway Company has every desire to conform strictly to the requirements of the commission as far as it is possible, I have the honor to be,

Yours, very respectfully,

(Signed)

R. J. MCCARTHY.

October 8, 1909.

Mr. R. J. McCARTY,

*Vice President & Auditor Kansas City Southern R. R. Co.,  
Kansas City, Mo.*

DEAR SIR: Your letter of October 5th, containing a discussion of the treatment of abandoned property as required by the form of accounts prescribed by the Interstate Commerce Commission, to Chairman Martin A. Knapp, has been referred to this office.

Professor Adams will be absent for some little time, but your very interesting discussion will be brought to his attention at the earliest possible opportunity, and, being of such importance, will receive his most careful consideration.

Very truly, yours,

\_\_\_\_\_, Acting Assistant Director.

THE KANSAS CITY SOUTHERN RY. CO.,

*Kansas City, Mo., Oct. 26, 1909.*

Hon. MARTIN A. KNAPP,

*Chairman Interstate Commerce Commission, Washington, D. C.*

DEAR SIR: In a communication of the 5th instant, the attention of the commission was invited to the embarrassment of the Kansas City Southern Railway Company due to the regulations concerning the accounts of steam roads, effective July 1st, 1909.

This communication was referred to the Bureau of Statistics and Accounts and on the 8th inst. that bureau advised that Professor Adams would be absent some little time but that upon his return the matter would be given consideration.

It being important to obtain relief at an early date and it being impossible to present the chief difficulties of the situation without special reference to technical details of accounts the honorable commission is respectfully asked for its further indulgence.

The Kansas City Southern Railway Company is making improvements in grade and alignment which involve the construction of about 29 miles of new main track at an estimated cost of \$1,200,000.00, and the abandonment of about the same mileage of the present main line which it would cost about \$723,000.00 to replace in kind. The salvage being estimated at \$113,000.00.

The net expenditure required for these improvements may, therefore, be stated thus:

Gross expenditure.....	\$1,200,000.00
Less salvage.....	113,000.00
Net expenditure.....	1,087,000.00

These improvements can be justified only upon the theory that the value of the whole property as a transportation proposition will be enhanced by at least the full amount of their cost, for under any other theory the management would stand convicted of a foolish if not a wilful and deliberate waste of means.

Therefore the management did not undertake this expenditure until convinced by extensive surveys and careful estimates that the value of the whole property as a means of inviting and transporting traffic would thereby be enhanced by at least \$1,087,000.00.

The only way in which this enhanced value can manifest itself and be made available is through increased business due to improved service and decreased operating expenses due to easier grades and better alignment.

That the company is entitled to a just return upon this increased value seems to require neither argument or demonstration.

This just return having been fairly earned, the integrity and accuracy of the accounts require that it shall be fully shown in all statements and reports of net earnings.

But the regulations in question require that the cost in kind of the abandoned line, \$723,000.00, less the salvage, \$113,000.00, or \$610,000.00, shall be charged to operating expenses.

Should this charge to operating expenses be made during the present fiscal year, the company might be forced either to pass the small dividend it is now able to pay or to meet the same under the suspicion of making payment from sources other than its earned net surplus, for the reports would show a de-

crease in net revenue which, as nearly as can now be estimated, may be stated thus:

Decrease due to arbitrary charge to operating expenses made under the regulations of the Interstate Commerce Commission concerning improvements made with a view to increased revenues and decreased operating expenses	\$610,000.00
Less estimated actual increase in net revenues due to the improvements	72,000.00
Net decrease in net revenues due to improvements made with a view to increasing the same	538,000.00

Thus, notwithstanding the fact that the company would have expended \$1,087,000.00 in order to increase its annual net revenues by at least \$72,000.00 and actually would have so increased them, the reports would show a decrease of more than half a million dollars.

Were this charge to operating expenses distributed over even so long a period as ten years the records and annual reports would show that the returns from the enhanced value of \$1,087,000.00 were \$61,000.00 less than a just and fair return, \$61,000.00 less than had been estimated, and in fact \$61,000.00 less than the amount actually and fairly earned.

That the company should be required to report its net revenues at many thousands of dollars less than the amount actually and fairly earned, and all because of a certain system of accounts, seems conclusive that such a system, at least to that extent, is radically wrong.

Furthermore, it has been shown that the expenditure of the \$1,087,000.00 for the improvements mentioned can be justified only upon the theory that the value of the whole property will be enhanced by at least an equal amount, and according to the best estimates obtainable it will actually be so enhanced.

This enhancement of value having been fairly established, the integrity and accuracy of the accounts require that it shall be fully shown in the records and reports.

But the regulations in question require that because of the expenditure of \$1,087,000.00 for improvements, which, judged by the highest available mathematical and commercial standards, should increase the value of the whole property by at least \$1,087,000.00, the records and reports shall show this value to have been increased by a net amount of only \$477,000.00.

The records and reports would thus show that the expenditure of more than one million dollars for improvements made with a view to enhancing the value of the property had resulted in an increase in value of less than one-half of the amount actually expended.

Such a record or report would on its face stultify the management, although in fact the utmost prudence would have been exercised and no mistakes would have been made.

It is manifest that any system of accounts which leads to such unfair and inaccurate results cannot in that respect with justice be enforced.

For these reasons among others more technical authority is respectfully asked for the Kansas City Southern Railway Company to defer making charges to operating expenses on account of property abandoned in the course of improvements made with a view to increased net revenue until the commission shall have given consideration to all the facts and merits of the case and rendered its decision. And to this end the writer will be glad to appear before the commission at its early convenience and will call promptly upon any of its representatives that may be designated.

Hoping for an early and favorable reply, I have the honor to be,

Very respectfully,

(Signed) R. J. McCARTY, Vice President.

NOVEMBER 18, 1900.

HON. JAS. S. HARLAN,

Commissioner Interstate Commerce Commission, Washington, D. C.

DEAR SIR: I have your note of November 8th, transmitting a letter dated October 26th, from Mr. McCarty, vice president and auditor Kansas City Southern Railway Company, relative to an application of addition and betterment rules to the case submitted by him in regard to improvements in grade and alignment. Mr. McCarty's letter of October 5th, with memorandum attached, is also before me.

After reading the communications from Mr. McCarty with care, it does not seem to me that anything need be said to elucidate for him the rules of accounting adopted by the commission. The communications show that the writer understands perfectly the principles involved.

The chief interest of the commission in the rules which it has promulgated lies in its desire to keep the property accounts from which the balance-sheet statement of cost of property is taken in line with the property actually used in the service of transportation. The fact seems to be that in making improvements in grade and alignment, the Kansas City Southern Railway Company has abandoned property to the amount of \$610,000.00 and has constructed, in place of the line abandoned, at a cost of \$1,200,000.00. The company desires to add the cost of this new construction to its property without making a credit to the \$610,000.00. Under the rules approved by the commission, the \$610,000.00 abandoned property would be credited to the property account; the \$1,200,000.00 would be charged to that account, and the result of the transaction would be recorded as an increase in the property account of the difference, \$590,000.00.

The point under consideration was submitted to the commission in my report on the Statistics of Railways in the United States for the year ending June 30, 1907. The following is quoted from pages 20 and 21 of that report:

"With regard to additions and betterments the situation is somewhat different. The general facts relative to this classification are well known, and the views of carriers respecting them have been compiled. The point of difficulty—that is, the point which makes this classification of such paramount importance—pertains to the treatment of abandoned property. Shall the value of abandoned property be kept in the capital accounts, or shall it be charged off? If charged off, shall it be charged to operating expenses or to profit and loss; shall it be by a single entry or prorated through a series of months or term of years? If prorated, what principle should govern the determination of the period to be covered by such prorating?

"This is the most serious of the technical questions yet raised in the development of a uniform system of accounts, and a point in which the public as well as the carriers have a vital interest. On the part of the public, the argument is strong in support of the proposition that the balance-sheet statement of 'cost of property' should cover only that property actually used in rendering the service of transportation, and that abandoned property should therefore be taken out of the accounts; but the argument of the stockholder also has merit, which is that—inasmuch as the property abandoned was abandoned to make way for providing the public with better facilities (for it must be held in mind that the question at issue arises in connection with additions and betterments), and, further, inasmuch as the first investment was necessary in order that the second investment might be made—it is scarcely just to require the stockholder to sustain the entire loss. It seemed appropriate to state this question, not for the purpose of discussion, but to call attention to the fact that the work of this division in the development of a system of standard accounts for railways has reached a point where further progress requires a definite expression of policy on the part of the commission. A sense of equity and an appreciation of business conditions, rather than legal or accounting technicalities, would seem to be the element out of which such a policy should be constructed."

The point is raised by the Kansas City Southern Railway Company that if the \$610,000.00 of abandoned property be charged to operating expenses in equal installments over a period of ten years, the net revenues from operations will not be adequate to pay a reasonable return upon the new investment. Should this prove to be true, would it not be evidence of the fact that the management had authorized an improvement before such improvement was warranted by business conditions? It would seem to me that the time when improvements involving the abandonment of large amounts of property should be undertaken ought to be determined by inquiring whether or not the improvement in question would result in an increased revenue or a decreased expense sufficient to pay a normal return upon the investment in addition to the charge for returning to the stockholders the original value of the property abandoned. The alternative to this method of procedure would be to burden the traffic for all time with an interest charge upon property no longer in existence. The accounts of the commission, as I understand them, are based upon the broad rule that, although railway corporations have a perpetual existence, each generation ought to meet the outlay for its own experiments. In no other way can the capitalization of railways be kept down somewhere near the inventory



value of the property actually used in rendering the service of transportation. The plan of accounting for which the Kansas City Southern Railway Company seeks the approval of the commission would make permanent the burden of an interest payment on \$610,000.00 with nothing in the property to represent this value.

Very truly, yours,

(Signed) HENRY C. ADAMS,  
In Charge of Statistics and Accounts.

NOVEMBER 26, 1909.

Mr. R. J. McCARTY,

*Vice President & Auditor,*

*Kansas City Southern Railroad Company,*

*Kansas City, Mo.*

DEAR SIR: Your letter of October 26 addressed to the chairman of the commission was referred to me upon my return to the city from the West for the reason that matters relating to the accounts of interstate carriers are somewhat under my personal supervision, although all technical questions in that regard are necessarily referred to Mr. Adams, our statistician, before they are acted upon by the commission.

I pursued that course with your communication, and I think the simplest reply that I can make to it is to hand you herewith a copy of the report that Mr. Adams has made to me. You are doubtless aware of the fact that there has been some discussion and criticism of the rules adopted by the commission relating to the manner of recording expenditures for additions and betterments. But if I interpret correctly the attitude of my colleagues on that question the discussion and the careful consideration of the criticisms that have been made have served to strengthen rather than to impair our view of the correctness of those rules.

If you have any further thoughts to express in this connection I shall be glad to hear from you and to communicate them to the commission, but I incline to the opinion from the careful investigation of the matter heretofore made by the commission that its position on these matters must be accepted as final.

Very respectfully,

(Signed) JAS. S. HARLAN,  
*Commissioner.*

THE KANSAS CITY SOUTHERN RY. CO.,

*Kansas City, Mo., Dec. 9, 1909.*

Hon. JAS. S. HARLAN,

*Commissioner, Interstate Commerce Commission,*

*Washington, D. C.*

DEAR SIR: I am obliged for your letter of the 26th ult., enclosing copy of report made by your statistician, Mr. Adams, upon my communications of October 5th and 26th concerning regulations of the commission prescribed for the accounts of steam roads, effective July 1, 1909.

In view of the privilege accorded in the last paragraph of your letter, the following discussion of Mr. Adams' report, which for convenience will be referred to as the report, is respectfully submitted.

As the report, evidently for clearness, omits the inconsequential item of salvage in the concrete case the same will be done in this discussion. This being understood, the concrete case may be stated as follows:

The Kansas City Southern Railway Company is building about 29 miles of improved main line which will cost \$1,200,000 and which will involve the abandonment of about the same mileage of old main line worth \$610,000.

Under the regulations of the commission the \$1,200,000 should be charged to capital, the \$610,000 should be credited to capital and charged to operating expenses, leaving in the capital account the difference of \$590,000.

The Kansas City Southern Railway Company requests that the \$610,000 shall be allowed to remain in the capital account as being more in accordance with the correct principles of accounting.

For convenience it will be assumed that six per cent per annum is a normal return upon the improvement and that the \$610,000 of abandoned property would under the regulations of the commission be charged to operating expenses in equal yearly installments during ten years.



The management of the company was moved to make the improvements in question by an estimated immediate increase in annual net revenue of about \$72,000 due partly to increase in earnings from better service and partly to decrease in expenses from reduced grades.

According to the report, however, the management would not have been warranted in making the improvements unless reasonably assured of an increase in annual net revenue, which may be stated as follows:

6% on increased capital account of \$590,000	\$35,400
1/10 of cost in kind of property abandoned	61,000

Total annual increase in net revenue necessary to justify the improvements, according to the report 96,400

It is certain that had the management adopted the theory contained in the report the improvements would not have been undertaken, for, as already stated, the prospective annual return is only \$72,000.

But even though the prospective returns should have been \$96,400 the management could not have justified the improvements under that theory.

For while it is provided that the stockholders shall be repaid the \$610,000 in equal annual installments during ten years no provision is made for interest on deferred payments. This must have been an inadvertence, for surely the commission would not deliberately deprive the company of a normal rate of interest upon the unreturned portions of an amount which the commission itself concludes should be repaid.

Whereas, to carry the theory of the report to its just and proper completion the company should receive from the public, and therefore, should earn at least 6% per annum on each installment from the date of the improvement to the date of repayment.

Therefore, under a just application of the theory of the report, the management of the Kansas City Southern Railway Company could not justify the improvements under consideration without a prospective increase in net revenue during the next ten years as follows:

	6% return on in- creased capital account.	1/10 of cost in kind of property abandoned.	6% interest on unre- turned portions of \$610,000.	Total.
1st year	\$35,400	\$61,000	\$36,600	\$133,000
2nd year	35,400	61,000	32,940	129,340
3rd year	35,400	61,000	29,280	125,680
4th year	35,400	61,000	25,620	122,020
5th year	35,400	61,000	21,960	118,360
6th year	35,400	61,000	18,300	114,700
7th year	35,400	61,000	14,640	111,040
8th year	35,400	61,000	10,980	107,380
9th year	35,400	61,000	7,320	103,720
10th year	35,400	61,000	3,660	100,060
	\$354,000	\$610,000	201,300	1,165,300

From these figures it follows that even were the prospective returns from the improvements \$96,400 but no more, the probable losses to the company under a just and proper application of the theory of the report would during the next ten years be at least the loss of 6% simple interest on unreturned portions of the \$610,000, or \$201,300, and if interest on this lost interest should be considered the loss would be much more.

As a matter of fact the figures clearly show that, under the theory of the report if justly applied, and it is, of course, assumed that the commission would permit nothing less, it would require a prospective immediate increase in annual net revenue of at least \$133,000 to warrant the company in making the improvements. Whereas, under the theory advanced by the Kansas City Southern Railway Company, and which is that heretofore in general use by carriers, an annual increase of \$72,000 would be sufficient.

Now, it is certain that many important improvements involving the abandonment of productive property of immense value are already in contemplation as being justified under the theory of accounting here advanced.

It is also certain that these improvements as a rule will not produce the large and immediate returns required by the theory of the report, and that, therefore, if that theory should be accepted by the carriers as a correct working hypothesis the improvements will not be made at all. Thus the theory by requiring such large and immediate returns will prevent the expenditure of millions of money during the next few years for valuable improvements which would otherwise be made.

That the expenditure of these millions would greatly stimulate business in general is beyond doubt; that the improvements would bring about improved service at decreased expense can not be questioned, and that improved service at decreased expense results in lower rates and higher wages is the lesson of experience.

The theory of the report, having for its practical consequence the loss of these great benefits to the present generation, can not be justified by its results.

To meet this condition the report falls back on the proposition that "each generation should meet the outlay for its own experiments."

In the development of railroad property certain improvements, such as misplaced or unnecessary sidings and spurs, may produce no returns whatever. Certain others, such as tracks to mines subsequently worked out, having served their several purposes, can no longer justify their existence. Certain others, such as obsolete buildings, machinery, and equipment, having been productive cease to be so by means of the changing conditions of progress which they themselves may have contributed to bring about. In every instance of this kind the carrier would naturally avail itself of the salvage and credit the original cost to capital, charging the salvage at market prices to its current assets, and the difference to income or profit and loss, as the case might be, and there would be no burden imposed upon posterity. This, however, would be done for the reason that the property had no value due to productiveness and would not be done because of any improvement that might be in progress.

On the other hand, however, there are many pieces of valuable property capable of producing indefinitely fair returns upon their cost which may well give way to progress in science, commerce, and the arts. Improvements involving the abandonment of such property unquestionably benefit future generations fully as much if not more than they benefit the present. Therefore, to burden the present generation with the total cost of any such improvement would be as unjust as would be the prohibition of State, county, and municipal bonds on the ground that the present generation should bear the total burden. In such a case what is true of the whole is manifestly true of any indispensable part. Therefore, as the report admits that the \$610,000 of abandoned property in the concrete case under discussion is a part of the expense of improvement which the public should pay, so should it concede that posterity should bear a part of the burden.

But granting for the moment that posterity ought to be relieved of any part of that burden, it is proper to inquire whether under the theory of the report the adequate relief would be furnished.

Under that theory the present generation would pay \$610,000 to relieve posterity of an annual fixed charge of 6%, or \$36,600. But if this \$610,000 were not paid by the present generation it would in some form or other be passed on to the next. This next generation would reasonably be able to make this amount earn 6%, or \$36,600 per annum.

The situation of posterity would therefore be as follows:

Annual gain by decrease of carriers' revenues .....	\$36,600
Annual loss of 6% interest on \$610,000 .....	36,600
Net gain .....	Nothing.

Therefore, the doctrine that "each generation ought to meet the outlay for its own experiments," even were it sound as to experiments, manifestly has no application to productive property abandoned in the course of improvements made with a view to increased net revenues.

The report, however, seeks to justify both the validity of this doctrine and its application on the ground that "in no other way can the capitalization of railways be kept down somewhere near the inventory value of the property actually used in the service of transportation."

It is, of course, not only right but also important that the capitalization of railways should be kept down to the proper value.

Concerning the proper value of railroad property, in the case of *Smith vs. Ames*, with which railroad officials generally are more or less familiar, and which is here quoted merely for convenience of reference, the Supreme Court of the United States ruled as follows:

"And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property."

In view of what has been stated, the four positions taken in the report and the deductions made therefrom may be given as follows:

1. According to the report, improvements involving the abandonment of property are not warranted without a prospective "increased revenue or a decreased expense sufficient to pay a normal return upon the investment in addition to the charge for returning to the stockholders the original value of the property abandoned."

In answer to this it was shown that the adoption of such a theory by the carriers would prevent many important improvements involving the abandonment of valuable property and thus work great injury to the public.

2. According to the report, the alternative to the position just given "would be to burden the traffic for all time with an interest charge on property no longer in existence."

In answer to this it was shown that in order to relieve the traffic of an interest charge for all time the public must pay the principal.

3. According to the report, "the accounts of the commission" (concerning property abandoned) "are based upon the broad rule that, although railway corporations have a perpetual existence, each generation should meet the outlay for its own experiments."

In answer to this it was shown that conceding this rule to be sound in the case of unproductive property abandoned, in the case of productive property abandoned in the course of improvements made with a view of increased net revenues, it places a load upon present business interest without the slightest degree relieving posterity of any equivalent burden.

4. According to the report, "in no other way can the capitalization of railways be kept down somewhere near the inventory value of the property actually used in rendering the service of transportation."

The answer to this was the affirmation of the Supreme Court to the effect that "the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration."

Thus, it would seem that nothing more is necessary to prove that the report of Mr. Adams does not furnish a defensible basis for the accounting of productive property abandoned in the course of productive improvements.

This being true, it becomes important to determine what the proper basis is, and in this connection the plan of accounting generally indorsed by carriers naturally suggests itself.

Under this plan the accounting of abandoned property is determined by whether it is productive or unproductive.

If the abandoned property is unproductive, its original cost is credited to capital, the salvage at its market price is treated as a current asset, and the balance is charged to income or to profit and loss, as occasion may make proper. This is done upon the theory that the property being unproductive has no value beyond the market value of its physical elements.

If the abandoned property is productive, its original cost less the value due to its productiveness is credited to capital, the salvage at market price is treated as a current asset, and the balance is charged to income or profit and loss, as the case may be. This leaves in the capital account the value due to the productiveness of the property at the time of its abandonment.

The total cost of the improvement less the salvage is then regarded as a permanent investment upon which the carrier is entitled to receive indefinitely a fair and reasonable return.

The only objection to be urged against this plan is that it allows the value due to the productiveness of property at the time of its abandonment to remain in the capital account as a permanent asset.

The only equitable way of removing this objection is for the public to repay the carrier the value of such productiveness in yearly installments, with normal interest on deferred payments.

But this is precisely what Mr. Adams has attempted to do and what as shown in the discussion of his report will prevent improvements, burden present business interests with the value of productive property abandoned in the course of productive improvements, and in no way benefit posterity.

In view of all that has been stated, the hope is indulged that the honorable commission will permit the Kansas Southern Railway Company to keep its accounts according to that basis which has been demonstrated to be most defensible and just to all concerned.

Because of the importance of the question, and because of the embarrassment under which the Kansas City Southern Railway Company is laboring, the early attention and advices of the honorable commission are earnestly solicited.

I have the honor to be,

Very respectfully,

(Signed)

R. J. McCARTY.

DECEMBER 14, 1909.

Mr. R. J. McCARTY,

*Vice President and Auditor, Kansas City Southern Ry. Co.,*

*Kansas City, Missouri.*

DEAR SIR: Commissioner Harlan requests me to acknowledge the receipt of your letter of December 9, referring to your previous communications of October 5 and 26, which were replied to by Mr. Harlan on the 29th ultimo, and to say that you will be further advised at the earliest possible moment.

Very respectfully,

*Secretary to Commissioner Harlan.*

802 SOUTH UNIVERSITY AVE.,

*Ann Arbor, Mich., May 31, 1910.*

Mr. R. J. McCARTY,

*Vice President and Auditor Kansas City Southern Railway Co.,*

*Kansas City, Mo.*

DEAR SIR: I have been requested by Commissioner Harlan to reply for him and for the commission to your letter of December 9th, 1909, relative to the commission's rules affecting abandoned property, as expressed in its classification of additions and betterments. This case, being the first of its kind which has arisen as a definite case in the administration of the commission's accounting rules, it was naturally made the basis of somewhat extended conference and correspondence, which I am sure you will accept as a reasonable explanation of the apparent delay in making final reply to your request.

My last letter to Commissioner Harlan touching this matter, dated May 7th, contains the following statement: "There is no misunderstanding between Mr. McCarty and the commission as to the interpretation of the accounts or as to the principle at issue. The difference is a fundamental difference of policy. If the commission holds to its rules relative to abandoned property, it can, in some degree, control the figure which is set up in the balance sheet as cost of property; and, inasmuch as this figure is one which the commission and the courts must use for measuring the rate which, from the constitutional point of view, is the reasonable rate, I can not see how the commission can hesitate to require strict compliance with its accounting rules relative to abandoned property."

I am now instructed that Commissioner Harlan, speaking for the commission, approves the above statement. It may, therefore, be accepted as the formal reply to your request, and as indicating that the commission can not allow the Kansas City Southern Railway Company to continue to charge additions and betterments to the property accounts without crediting to the same accounts the value of the property abandoned in connection with such improvements.

I do not know that I shall be able to add anything to the discussion of this fundamental question of accounting policy, but I should like to emphasize the

point of view from which the matter is regarded by the commission's system of accounts.

*First.* The accounting system promulgated by the commission recognizes that the immediate burden incident to making certain improvements may be so great as to deter a carrier from undertaking such improvements, and on that account it provides that the public should assume a certain portion of that burden. That this is the correct interpretation of the commission's rules respecting abandoned property can not be questioned. To write off through operating expenses an asset which represents property abandoned in connection with improvement work is in effect to create for the carrier a market for such property at a price equal to the cost to replace it. The public is the purchaser and makes payment to the carrier by continuing for a time the old schedule of rates for passengers and freight, notwithstanding the decreased cost and the increased revenue resulting from improvements. What, now, is the loss to the stockholder? Unless the property abandoned was paying a dividend at the time of its abandonment (which was not the case with the Kansas City Southern Railway Company) the stockholder incurs no loss traceable to the policy of improvement; in case, however, this abandoned property contributed to the dividends, the immediate loss to the stockholder is the loss of the dividend upon the abandoned asset during the period of its expungement. It is certainly reasonable that the stockholder should be called upon to bear this much of the burden, especially when it is realized that in all probability the compelling reason for the improvements is to put the property in shape to gain a larger share of competitive traffic, or to conserve the present volume of traffic against the competition of other lines.

*Second.* The foregoing implies that the accounting rules of the commission require a gratuitous contribution from the public. A further analysis of the situation, however, makes it evident that this contribution is one which the public can not well avoid. The most that can be said is that in the case of a carrier whose stock is paying dividends the stockholders participate with the public in carrying the burden of the improvements. Suppose the Massachusetts rule to be adopted, and that abandoned property be written off through accumulated surplus; it is the public that has contributed to the creation of that surplus. Suppose the value of the property to be amortized through charges to operating expenses subsequent to the date of its abandonment; the result is the same—the public pays for the abandoned property. Suppose property which in fact is abandoned remain a property asset on the books of the company, to be supported by passenger and freight rates in perpetuity; it is still the public that pays the bill. The full extent of the rule of the commission relative to abandoned property, therefore, is to prescribe the method according to which the public should meet its burden and the manner in which this transaction should be recorded in the accounts of the carriers. It is of some importance that this fact be recognized; otherwise, the commission might be charged with spending the shippers' money for the benefit of the stockholders.

*Third.* It may be asked why the commission adopts the rule that the book value of property abandoned should be amortized during a term of years, rather than that this value should be continued on the ledger and made the basis of interest or dividend payments in perpetuity. There are several answers to this question. In the first place, as already stated to you, it is believed to be sound policy that every generation should pay its own debts. In the second place, the question of capitalization, by which I mean the amount of securities outstanding against the property, is involved; and it has been thought proper by the commission to adopt those accounting rules which will tend to limit the increase of permanent securities to the increased investment in the property on account of improvements. In the third place, the burden assumed by the public is less under the rule promulgated by the commission than under the practice which carriers have heretofore followed. To put this specifically, using the case submitted by you, the question is: Which is the heavier burden, a promise to pay \$61,000 a year for ten years, or a promise to pay \$36,600 a year in perpetuity? The measure of these respective burdens is their present worth. The present worth of a \$61,000 ten-year annuity at six per cent is \$486,960; the present worth of an annuity of \$36,600 in perpetuity at six per cent is \$610,000. There is thus an actuarial reason in the support of the commission's rule, although, personally, I do not place so much emphasis on figures of this sort as I do upon the general policy that in matters of credit financing each generation should close its own accounts.

There are a few points, or expressions, in your communications with which I cannot quite agree. Thus, on page seven of your letter of December 9, 1906, addressed to Commissioner Harlan, you refer to the \$610,000 of abandoned property as "a part of the expense of improvement." That depends entirely on what you may mean by the word "expense."

On page seven of the same letter you submit a figure to show that it is immaterial to the public whether it expunge the principal of a debt, or pay the interest in perpetuity. Of course, the equation balances, but are you quite justified in assuming that money left in the hands of the public will be converted into capital and thus accumulate in perpetuity a six per cent return to the public? You are comparing a legal demand upon the public with a very uncertain return to the public.

You say, further, that the improvement in question was estimated to contribute \$72,000 increased net revenue, and state that, under the order of the commission, it must promise a net revenue of \$133,000 for the first year before the improvement can be undertaken. I can not think your argument in this particular is very conclusive, except as illustrating the fact that the commission's rule relative to abandoned property will tend to exert some influence upon the choice of time when improvements of the class under consideration should be made. As a technical query, however, I am forced to ask how you arrived at the estimate of \$72,000 increased net revenue due to the improvement, why you assume 6 per cent in your illustration, and how, in view of the fact that the Kansas City Southern Railway Company has paid no common stock dividend since 1900, you can defend the proposition that the stockholders are entitled to interest on the unreturned portion of the property.

In the latter part of your letter you draw a distinction between the abandonment of productive and unproductive property. This point is made more clearly in your first communication. This distinction is appreciated by the system of accounts which the commission has promulgated. Thus, the abandonment of an unproductive asset is charged to profit and loss; that is to say, to a surplus accumulated during the time in which the asset is supposed to have been productive; whereas an asset productive at the time of its abandonment is amortized through a period subsequent to the improvement which necessitates its abandonment, on the theory that this improvement will tend to increase net revenue. I speak of this, thinking possibly you may have overlooked the fact that the commission's rules as promulgated recognize the analysis which you suggest. The point which the commission can not concede is the suggestion that because property is productive at the time of its abandonment its record value ought to continue in the property accounts. In this matter the commission rests upon the broad principle that, in the case of a public-service industry, the property statement on the balance sheet should be confined to the property used by the carrier in the rendering of service.

Very respectfully, yours,

H. C. ADAMS,

*In Charge of Statistics and Accounts.*

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,

EXECUTIVE OFFICES, 25 BROAD STREET,

*New York, February 29, 1911*

Prof. HENRY C. ADAMS,

*Director of Statistics and Accounts,*

*Interstate Commerce Commission, Washington, D. C.*

DEAR SIR: As early as the fiscal year 1905-6 the management of this company was convinced of the necessity for improving the condition of its roadway and equipment, especially the former. It was, and continues to be, in active competition with powerful rivals operating in the same general territory. The character of the road as a trunk line, resulting in a long average haul and the prevalence of low-class traffic, necessarily entail a low average freight rate. These conditions rendered it imperative to reduce operating costs to a minimum if traffic were to be handled in large volume and if any substantial profit were to be realized from the company's operations.

In June, 1906, Mr. Horace G. Burt, a consulting engineer of Chicago, was employed to make an exhaustive examination of the conditions affecting the physical property and report on the means, in his opinion, best adapted to its betterment. On June 25, 1907, his report was rendered. The principal recom-

mentation was one looking to an extensive programme of grade reduction, preference being given to a line of .5 of 1 per cent in both directions.

On May 20, 1909, a circular letter was addressed to the stockholders by the board of directors, through its chairman, following the call of April 29 preceding for a special meeting of the stockholders on June 29, 1909, to approve, among other things, the creation of the Refunding and Improvement mortgage, authorizing \$21,000,000.00 of bonds, of which \$10,000,000.00 was to be issued upon the execution of the mortgage. The said circular letter specified the uses to which the proceeds of the initial issue were to be devoted. The following is an extract therefrom, and applies to the work which is the subject matter of this application.

"2. To reducing grades to one-half of one per cent on three full operating divisions, aggregating 41 per cent of the total length of the line, \$1,250,000.00."

The funds were provided as contemplated; they were appropriated by the executive committee to the ends set forth in the circular letter above mentioned, and its action in the premises was duly ratified by the board of directors.

At seven of the points involved, stated in the accompanying summary, it was found that the aggregate cost of grade reduction to .5 of 1 per cent, on the original location, would be \$3,101,300.74.

At the same points a grade of .5 of 1 per cent could be obtained on a new and different location by the employment of material released from the line to be abandoned of the value of \$104,405.25 and further aggregate expenditure of \$875,985.14. This would leave salvage from the abandoned line, not used in the construction of the new line, of the estimated value of \$10,874.00.

The difference in cost of obtaining substantially the same end under the two alternatives is as follows:

Cost of reducing grade to .5 of 1 per cent on the original location	\$3,101,300.74
Cost of reducing grade to .5 of 1 per cent on a new location, exclusive of old material released and used	\$875,985.14
Less value of old material released and not used	10,874.00
	\$865,111.14
Difference in cost	2,236,189.60

By the selection of the new location, therefore, substantially the same result could be attained at little more than one-fourth of the cost of revision on the original right of way. In the judgment of its officers this seemed to be overwhelmingly in the interest of the company and of all others in any way concerned; and, indeed, it was dictated by necessity itself, for the reduction of grades at the higher cost stated would not have been justified for years to come. Accordingly the new location was determined upon.

Had the company elected to reduce its grades on the original location, it would have been at liberty under express authority conferred by the classification of expenditures for additions and betterments, first issue, effective July 1, 1909, and by the first revised issue of the same, effective July 1, 1910, promulgated by the commission, to capitalize the entire expenditure of \$3,101,300.74, a sum almost four times as great as the expenditure actually incurred.

Having adopted a different location, in the obvious exercise of prudence and good judgment, and with the same object in view, the sum which it is authorized by the same classifications to charge to its property accounts is approximately as below:

Cost of reducing grade to .5 of 1 per cent on the new location, exclusive of old material released and used	\$875,985.14
Value of old material released and used	104,405.25
	\$980,390.39
Less estimated cost to replace in kind the line abandoned	579,111.00
Balance subject to capitalization	401,279.39

Surveys were made and plans prepared with the object of grade revision; the provision of funds was authorized by the stockholders upon the representation that they were to be devoted (in part) to the reduction of grades; such funds were appropriated and expended with that object in view, changes of line not in any case being considered except as a means to that end.



The management feels that the classifications of the commission, as above interpreted, do not lend suitable encouragement to frugality and economy of expenditure, but tend, on the contrary, to encourage extravagance; that their requirements operate to postpone needed improvements; that their full and literal enforcement would constitute an invasion of the company's property rights; and that the detail of location or the degree of change in location is of itself insufficient to support such invasion; and that therefore they were an undue hardship.

For these and any other reason or reasons not here specifically stated your honorable body is petitioned to afford relief by the issuance of an order authorizing the company to charge the entire actual expenditure for grade reduction herein mentioned, less salvage not employed in the reconstructed line, to additions and betterments.

The documents below stated accompany this application:

Comparative statement of classified revenue tonnage for the years ended June 30, 1909 and 1910.

Map of the Kansas City Southern Railway and the Texarkana & Fort Smith Railway.

Report on the proposed revision of grades and alignment of the main line of the Kansas City Southern Railway, Kansas City, Mo., to Port Arthur, Tex.—Horace G. Burt, June, 1907.

Notice of special meeting of stockholders June 29, 1909, dated April 29, 1909.

Circular letter to the stockholders of the Kansas City Southern Railway Company, dated May 20, 1909.

Summary showing old line abandoned, new line constructed, cost of reducing old line to 5½ grade, cost of replacing in kind old line abandoned, cost of constructing new line with new material, salvage from abandoned line not used in construction of new line taken into stock, and estimated cost of constructing new line, using old material, viz. value of old material used, and all other costs together with supporting detail.

Maps and profiles showing old line abandoned, new line constructed, etc.

By order of the chairman of the board.

Yours, respectfully,

(Sd)

G. C. HAND, Secretary

MARCH 11, 1911

MR. G. C. HAND,

Secretary Kansas City Southern Railway Co.,

25 Broad St., New York, N. Y.

MY DEAR MR. HAND: I received your letter of February 26th, together with the express package containing the blue prints and the report of the proposed revision of grades and alignment on the main line of the Kansas City Southern Railway Company.

After a careful perusal of your letter, and comparing it with my letter of June 17, 1910, addressed to Mr. R. J. McCarty, a copy of which is herewith enclosed, I can not discover any grounds for reopening this case. Please note the last paragraph of my letter to Mr. McCarty.

In order that you may fully understand the reason for my letter to Mr. McCarty, may I state again, as I supposed I had explained to you when you were in Washington, that in a similar case an examination by this office of the items which the engineers had said should be credited to the proper account in accordance with the classification of additions and betterments includes items which in our judgment ought not to be so credited. It occurred to me that possibly the Kansas City Southern Railway Company had made similar misinterpretations of the rules in applying them to the improvement work under contemplation. It was for that reason, and not because this office desired to open up again the correctness of the accounting rules promulgated by the commission, that my letter to Mr. McCarty was written.

From my cursory examination of the papers submitted I do not see that any new facts are presented, and for that reason I have refrained from submitting your letter, with the accompanying documents, to the commission.

Very respectfully, yours,

HENRY C. ADAMS,

In Charge of Statistics and Accounts



KANSAS CITY, Mo., July 27, 1911

Hon. JUDSON C. CLEMENTS,

*Chairman Interstate Commerce Commission, Washington, D. C.*

DEAR SIR: The Kansas City Southern Railway Company is making extensive improvements and rearrangements at one of its division terminal points which involve the abandonment and dismantling of certain roundhouses and shop buildings which the business of the company has outgrown and the class and design of which has become obsolete.

The improvements in question not only involve considerable changes of grade, but also changes of location of new and improved roundhouses and shop facilities.

In my judgment, and in the judgment of the management, the abandonment and dismantling of these buildings constitute a permanent abandonment of the same not only on account of the change of location and of the new conditions making such changes necessary, all of which were due principally if not entirely to conditions independent of the operations of the road, but also on account of the fact that the new buildings to be erected are of an entirely different type and design.

Accordingly it would seem that these abandoned buildings should be treated as property abandoned and not replaced, and as such the cost of the same is, in my opinion, chargeable to profit and loss instead of operating expenses—this upon the theory that the current operating expense is not properly chargeable with any of the loss or expense involved in the abandonment and dismantlement of this property.

There is some question, however, as to the exact meaning and intent of the classification promulgated by your honorable commission concerning the accounting for abandoned property, and for this reason I would respectfully request a ruling upon this point at an early date.

I have the honor to be,

Yours, respectfully,

(Signed)

R. J. McCARTY.

WASHINGTON, D. C., July 31, 1911.

Honorable JUDSON C. CLEMENTS,

*Chairman Interstate Commerce Commission, Washington, D. C.*

DEAR SIR: We beg to thank you herewith letter addressed to you from Mr. R. J. McCarty, Vice President and Auditor of the Kansas City Southern Railway Company, dated July 27, and on Mr. McCarty's behalf respectfully ask reply thereto at your early convenience.

Yours, very truly,

(Signed)

BRITTON &amp; GRAY,

*Attorneys Kansas City Southern Railway Co.*

AUGUST 7, 1911.

Mr. R. J. McCARTY,

*Vice President and Auditor**The Kansas City Southern Ry. Co., Kansas City, Missouri.*

DEAR SIR: Your letter of July 27th, addressed to the Hon. Judson C. Clements, chairman of the commission, requesting an interpretation of the commission's classification in connection with the "abandonment and dismantling of certain roundhouses and shop buildings" has been referred to me for reply.

Your letter conveys the impression that the improvement project in which your company is engaged is clearly a replacement of facilities rather than an abandonment. I am of the opinion, therefore, that your proposal to consider the dismantled structures as abandoned property and to charge the cost thereof to profit and loss instead of to operating expenses is not in accordance with the commission's rules.

Yours, very truly,

(Signed)

CHAS. A. LUTZ,

*Chief Examiner of Accounts.*

AUGUST 7, 1911.

Messrs. BRITTON &amp; GRAY,

*Attorneys and Counsellors at Law,**Monsey Building, 1329 E. Street, Washington, D. C.*

GENTLEMEN: Enclosed please find copy of a letter from this office, under date of August 7th, addressed to Mr. R. J. McCarty, Vice President and Auditor

of the Kansas City Southern Railway Company, in reply to his letter of July 27th, which was transmitted by you to the Honorable Judson C. Clements, chairman of the commission, on July 31st.

Yours, very truly,

(Signed) CHAS. A. LUTZ,  
Chief Examiner of Accounts.

Enclosure.

#### Recross-examination by Mr. DENISON :

Q. That large decrease in the net income, as compared with prior years, seems to have been due principally to a decrease in the freight revenue?—A. If you will turn to another part of the report, it explains that in detail. I will point it out to you. Here it is [indicating].

Q. At the passage you point out to me, it appears to be indicated that the chief losses of freight revenue were in lumber, which is stated to have been caused mainly by shutting down of nearly all of the principal sawmills, caused by labor trouble, wet weather, and on petroleum and oil, due to construction of pipe lines. Those are the largest items?—A. Yes, sir.

Mr. DENISON. That is all.

#### Cross-examination by Mr. NEEDHAM :

Q. How does this net revenue compare with the former years?—A. It is much less, but I really do not remember the figures. I think you will find it in the comparisons with the year previous. It is stated in there. I do not like to state the figures, because I may be mistaken.

Q. Do you know how much less?—A. I could not state from memory. If you will give me the report I think perhaps I can tell you.

Q. I hand you the report.—A. The net earnings were \$699,646.28 less than they were the preceding year.

Q. That much less?—A. Yes, sir. There were some changes in the fixed charges and income entries that do not show here. That is just a straight comparison, but I think practically that will be the difference or very close to it. There was a very large falling off.

Q. You stated that it was expected that these improvements would increase the net earnings, otherwise they would not be justified.—A. As a general proposition they would; yes.

Q. These improvements are now completed and are effective so far as affecting the revenues of the company are concerned?—A. The company is not getting the full benefit of it, because there are additional improvements going on that are interfering with the facility of operation. For instance, these improvements that are under consideration here related only to certain operating districts of the line. Since then, or about the time they were completed, there were similar improvements begun upon other operating districts, and until the whole work is done and an opportunity to get things settled and get rid of all the disturbing influences that such things have upon the service of the road, the company does not feel it will realize the full benefit of these improvements.

Q. But you would receive some benefit from the operation as stated by the engineer yesterday?—A. Yes; they would. They are receiving some benefit from the part that has been already completed, but that benefit is to some extent counteracted by the disadvantages

of this other, so you can not locate it and determine just what it is going to be. That is what I had in mind.

MR. NEEDHAM. That is all.

Redirect examination by Mr. Wickwire:

Q. Will you just state briefly what peculiar conditions existed during the last year which had a bearing upon the amount of the company's earnings?

MR. DENISON. You mean other than those he stated to me?

MR. WICKWIRE. I do not know that he stated them all to you.

THE WITNESS. There was a decrease in freight revenue from corn caused by the general falling off in corn shipments into Mexico and Texas, which amounted to \$44,210.96; from hay and straw caused by shutting down of the lumber mills on December, 1911, and until March, 1912, due to labor troubles and extreme wet weather. When these mills were running they used a great deal of hay and straw for their livestock. When the mills shut down, they turned the livestock out to pasture and did not need it.

From fruits and vegetables, which was caused principally by shortage of the peach crop down in the Ozarks as compared with previous years.

From lumber, which was caused by the shutting down of the principal saw mills.

I did not give the amounts of those. From hay and straw \$29,072.70; from fruits and vegetables, \$19,638.44; from lumber, \$71,753.55; from ties, posts, logs, and piling, caused by retrenchment of the railroad company, labor troubles, and wet weather, \$18,128.98; from petroleum and other oils, due to construction of pipe lines, \$361,133.86. From iron of all kinds, caused by cessation of shipments of the pipe due to completion of pipe lines, \$137,224.37. The aggregate of all these figures is \$1,014,463.86. As against that there were certain increases in freight revenue which were caused from coal by the fact that in 1911 there was a miners' strike on, which did not affect the operation of the coal company during 1912. That resulted in an increase of \$85,868.39. Then there were quite a number of increases which were due principally to the development of the territory; in cotton, \$73,990.36; in flour, \$20,283.16; other mill products, \$118,543.37; cooperage stock, \$11,715.26; cement, brick, and lime, \$37,240.28; agricultural implements \$9,648.87; wagons and other vehicles, \$3,802.14; wines, liquors, and beers, \$2,128.01; immigrants moveables, \$3,585.57; miscellaneous net increases, \$26,856.75; making a total increase of \$393,762.86, or a net decrease in freight revenue of \$620,701.

Q. Is there any way in which a railroad can guard against these casual reductions in the volume of its traffic?—A. If there is any, it has never been discovered.

By Mr. NEEDHAM:

Q. Those sums which you have given are the gross earnings in freight?—A. Yes, sir.

Witness excused.

WILLIAM H. WILLIAMS, a witness of lawful age, called by and on behalf of the petitioner, having been first duly sworn, is examined.

By Mr. WICKWIRE:

Q. State your full name.—A. William Henry Williams.

Q. Where do you reside?—A. Plainfield, New Jersey.

Q. What is your business?—A. I am in the railroad business.

Q. What official position do you hold?—A. I am the third vice president of the Delaware & Hudson Company and a member of its board of managers; I am vice president and member of the executive committee and member of the board of some thirty odd companies in which that company is interested, such as steam railroads, trolley lines, boat lines, hotels, coal companies, iron-ore mines, etc. I am also on the boards of other companies in which the Delaware & Hudson is not interested, including the Kansas City Southern.

Q. How long have you been a director of the Kansas City Southern?—A. Since some time in the middle of 1909, I think about August.

Q. Of what department of the Delaware & Hudson Company do you have charge?—A. I am specifically in charge of the treasury and accounting departments, and in addition such other work as may be assigned from time to time by the president or the board, and in the absence of the president I usually act for him in corporate matters.

Q. Will you state what has been your experience as a railroad man and as an accountant?—A. I began my railroad work in 1890 in the freight station of the Pennsylvania & Hocking Valley at Toledo, Ohio, as assistant to the cashier. Sometime later, owing to severe illness, I had to withdraw from the service, and while recuperating took a course in a business college, including a course of bookkeeping, in which I graduated. Subsequently, I was on the engineer corps of the Pittsburgh & Lake Erie, and in February, 1892, went with the Pennsylvania lines west of Pittsburgh as stenographer to the superintendent of telegraph. In September of that year I was promoted to the general manager's office and passed over various desks until in 1896 I was made secretary to the general manager. I think about 1900 I was made chief clerk to the fourth vice president. Then I took service with the Baltimore & Ohio, and was first assigned to special work under the president, and then made assistant secretary of the company and devoted my time very largely to the introduction of economies on the Baltimore & Ohio. Subsequently I was made assistant to the general manager of the Baltimore & Ohio. I resigned from the Baltimore & Ohio to take service with the Frisco and the Chicago & Eastern Illinois as superintendent of freight transportation, yard and station service, and had charge of the freight movement on some 6,000 miles of line. Owing to a change of management I left there about October 6, 1904, and my next work was as statistician for the General Managers' Association of New York, which was, I think, in January or February, 1905. Shortly thereafter I became traffic manager of the Merchants & Manufacturers Association of Pittsburgh, and then traffic manager of the Chamber of Commerce of Pittsburgh, and at the same time continued as statistician for the General Managers' Association of New York, and also became statistician of the General Managers' Association for Chicago. In May, 1907, I resigned in Pittsburgh and took service with the Delaware & Hudson Company as assistant to the president. Owing to the illness of the president, three weeks after my taking service, my work was

somewhat changed, and I looked after his work until his return the first of October, and on the second day of October, 1907, I was elected third vice president of the company in charge of finances and accounts, in which position I have continued up to to-day. I might also say that while with the Baltimore & Ohio I was treasurer and had charge of the accounts of the American District Telegraph Company, of Baltimore.

Q. You are familiar with railway accounting, are you not?—A. Yes, sir.

Q. Are you familiar with the various regulations and classification that have been promulgated from time to time by the Interstate Commerce Commission?—A. I am. I am a member of the Association of American Railway Accounting Officers, and a member of the committee on corporate general and fiscal accounts, which has had general supervision or consideration of the accounts promulgated by the Interstate Commerce Commission—I mean as representing the railroads.

Q. Are you familiar with the regulations and classifications which are involved in this case?—A. I believe so; yes, sir.

Q. And with the questions which are involved in this case?—A. Yes, sir.

Q. Will you state whether in your opinion the estimated cost of the parts of the roadway of the Kansas City Southern, which were abandoned in connection with the grade reductions involved in this case is properly chargeable against operating expense?—A. My best opinion is that it would be an improper charge to operating expense.

Q. Will you state whether in your opinion the cost of the grade reductions involved in this case, which have been made off the line of the road, should be charged to the capital account without deduction?—A. My opinion of that is that it is a question of policy which the management of the company should decide, and that it is entirely proper to make that charge if in their opinion they wish to do so.

Q. You mean it is entirely proper to charge it to additions and betterments?—A. Yes, sir.

Q. Will you state the reasons for your opinion upon those two propositions?—A. In the first place, so far as the operating accounts are concerned, I feel that the operating accounts are the measure of the earning capacity of the plant, of its true earning capacity; that in that depends largely the credit of your company; that a legitimate operating expense is one which is incurred in the production of the revenues, against which they are offset to determine your net revenues; or, stated in another way, they are the class of expenses which would cease if you discontinued the operation of your road to-day. So far as the additions to your capital account are concerned, my personal opinion is that the measure of those, and the very basis in which, as an operating man and as an executive officer I have made recommendations to the board for consideration and as a member of the board have considered them, is whether or not the increased net return as a result of this expenditure is sufficient to warrant the expenditure being made, and if they fail to meet that test, we regard it as an improper charge, unless it is a question of government policy, such as the elevation of tracks, over which we have practically no

control, and where the net return is not sufficient to pay us a return on our investment.

Q. In other words, if I understand you correctly, it is your view that in determining whether improvements of this character should be made or not, the proper and vital question for consideration is whether it is reasonably to be expected that the increased expenditure will produce a reasonable and fair return?—A. Yes, sir; that is correct.

Q. And if it were not reasonably to be expected that the increased expenditure would produce a reasonable return you would regard the expenditure as unjustifiable?—A. I would, unqualifiedly so.

Q. You understand, do you not, that if the improvements in this case had been made on the line of the road they would have been substantially all chargeable to capital account under the regulations of the Interstate Commerce Commission?—A. Substantially so, yes, sir. There would be some slight charges to operating expenses under the commission's order.

Q. But the very large part of all that expenditure would be chargeable to capital account. A. I should say not less than ninety per cent.

Q. Do you know of any reason in accounting for a distinction between the method of treating the expenditure for a grade revision, dependent upon whether the improvement is made upon the right of way or upon adjacent ground?—A. My own feeling is that the question of accounting is not the controlling factor; that the real question is the purpose for which the expenditure is made, and after determining the purpose for which you make the expenditure you then, by your accounts, reflect what action has taken place; that is, it is what has been done that is the controlling factor, and not the accounts.

Q. And in recording what was done do you know of any reason for, in one case, making the charge substantially all to capital account where it is on the original roadbed, and in the other case, as illustrated in this suit, charging about two-thirds of it to operating expense and one-third to capital account?—A. No; I do not.

Q. Was the financial condition of this railroad such that it could have paid the expenditures necessary for these various improvements and the others contemplated as part of this program out of its earnings?—A. I was not a member of the board at the time this work was authorized and could not state from my personal knowledge what its conditions then were. I do know that it would have been embarrassing to take care of any annual charge on any basis of five-year or ten-year distribution in connection with the actual results for the fiscal year ended June 30th, 1912, because, beyond the six pieces of work that are directly involved in this case, there are many other pieces of work involving the same principle, and the charges would have been more than those involved in this case to be handled in that way.

Q. Then there was a large amount of expenditures involved in this program for grade reductions upon the right of way, was there not?—A. Yes, sir; and others off the right of way.

Q. I said in addition to those off the right of way.—A. Yes, sir.

Q. And the company was required, in order to finance all of these improvements, to borrow money upon its bonds?—A. In order to

finance the improvements the company had to raise money. It was the best judgment of the management that that money could be raised to the best advantage by the sale of a particular class of securities, which was sold to finance this undertaking. Possibly you could have borrowed the money on short-time notes or in other ways, but this got us the money at the lowest rate of interest. That was their object.

Q. Was the fact that this railroad company was paying its dividend upon its preferred stock an important factor in enabling the road to borrow this money?—A. To the extent, at least, that the credit of any company is an important factor in borrowing money or raising money through the sale of its securities. A company not earning and not paying a dividend does not enjoy the same credit as one which does earn and does pay a dividend, and as the margin over and above any fixed charges on interest-bearing securities already outstanding, plus any which you contemplate issuing, tends to increase, the credit increases, you are able to place your securities at a lower rate of interest. Just as an illustration, I might state that I happen to know of conditions on two properties. On the Delaware & Hudson we are able to borrow our money at slightly above a four per cent basis, while the Kansas City Southern has to borrow its money at slightly above a five per cent basis. There is a difference of one per cent in the amount of interest that each has to pay in order to get money, and that is due to these relative conditions about which I just spoke.

Mr. NEEDHAM. If your honor please, his statement of what are the relative conditions between these roads as affecting the credit of the roads introduces into this record a very broad inquiry. It hardly seems to me proper that the witness should extend this record with his opinion of the reasons for the difference in credit between this company and another company. We might be able, for instance, by going into a line of testimony to show that conditions on the Delaware & Hudson are very different in very many particulars from the ones he names which affect the credit of the road. I do not object to the use of the illustration that the Delaware & Hudson borrows money at a less rate of interest, because it is well known that the credits of roads do vary; but when he goes to state the reasons for them, I think that is an improper thing in the record, because it opens up the inquiry. We either have to stand by that or we have to go into the inquiry as to what is the real cause of the difference in the credits between these two companies.

The COURT. I think it may go out, for the reason that it would not seem to be material or relevant to the inquiry before the court.

Mr. WICKWIRE. I have no objection, if your honor please. I think it is proper enough as an illustration, but for the purpose of injecting any questionable issue of fact in the case I have no desire to have it remain. That portion of the witness's answer which begins with the words, "Just as an illustration," I am willing should go out.

The COURT. Very well.

By Mr. WICKWIRE:

Q. The mortgage upon which the money was borrowed to finance these improvements was a second mortgage, was it not?—A. That is not what it is called. It is a refunding mortgage.

Q. But it is subordinate to the first mortgage covering the railroad company's property?—A. That is my understanding; yes, sir.

Q. And a railroad is hampered and perhaps prevented from borrowing money upon a second lien, is it not, unless it is paying a dividend or is showing substantial earnings above all of its requirements?—

A. I do not feel that that applies particularly to that particular class of securities. I think it applies equally to all securities, possibly to a varying degree, depending upon the class of security involved.

Q. But the question of whether a railroad company is paying its preferred dividend or not is an important element in determining its ability to borrow money?—A. That is my personal opinion.

Mr. Needham, this is my first time on the stand, so you will have to pardon me. I do not know whether this comes in under the other objection or not.

There is this important feature in connection with the marketing of these securities: My opinion is that the United States Government enjoys a preferred market in its securities because those securities are the basis for circulation of the national banks, and they are able, by reason of that preferred market which we do not enjoy—we can not place our securities there—to obtain their money at a less rate of interest. In like manner, under the laws of New York State and Massachusetts and some other States, the railroads enjoy a preferred market if they meet certain conditions; that is, the investors for savings banks and insurance companies and trustees of trust estates—and conservative buyers follow their lead very largely—are limited in the investments they can make, for instance, in New York, to the securities of those companies which have paid a dividend for five years, and in Massachusetts, ten years; so that the aim of all roads is to put themselves in shape where they can enjoy that preferred market for their securities, which industrial securities do not enjoy. So that the question of a dividend is such that you must have a dividend to get to that preferred market, and that is what we usually term investment securities. As we approach that, our credit necessarily improves.

Mr. Wickwire, You may cross-examine.

Cross-examination by Mr. NEEDHAM:

Q. A Government bond is not taxable. I suppose that has some bearing upon its market value, has it not?—A. A railroad bond is not taxable because the railroad pays the recording tax, and it then is not taxable, at least in the State in which it is issued, and it is placed on an equal footing to that extent.

Q. I see by the petition in this case, on page 3, the statement is made with reference to the issue of this mortgage, this refunding mortgage. The amount of it is \$10,000,000?—A. Yes, sir.

Q. The first item as given to be taken care of out of the sale of that refunding mortgage is to pay off the collateral gold notes on July 1, 1909, \$5,100,000. Is that correct? Is that the purpose?—A. I expect it is correct. I was not a member of the board and not connected with the company at the time that transaction took place.

Q. Were you a member of the board when the money was paid?—A. No; that was in August, 1909, as I recall, that I went on the board.



Q. You had nothing to do then with the application of more than half of this money—A. (Interrupting.) No, sir.

Q. (Continuing)—to the payment of existing collateral gold notes?—A. That is correct.

Q. Those notes matured July 1, 1909, did they not?—A. I could not state from my personal knowledge.

Q. Did they mature at that time or is that the date of them?—A. They must have matured at that time.

Q. Was not that the compelling motive in issuing those bonds?—A. Not being a member of the board when that mortgage was executed and when the policy was defined, I could not state.

Q. Are the rest of the items stated here correct?—A. I would accept them as correct. I did not handle the books of the company.

Q. Then the fact is that these refunding bonds were issued for other purposes than the grade improvements?—A. The annual report shows that they were. The annual report which you had here shows that they were issued for other purposes. The application of the proceeds is shown in the annual report for the fiscal year ended June 30th, 1912.

Q. That is this printed report which was here this morning?—A. Yes, sir.

Q. And that appears in that report?—A. Yes, sir.

Q. In this statement the amount of this \$10,000,000 applicable to grade improvements, reducing the grade to one-half per cent, is put down as \$1,250,000. Would you say that item was the compelling cause for issuing those bonds?—A. I do not know. I was not on the board at that time.

Q. Would you expect that that would be the compelling force for issuing \$10,000,000 of bonds?

Mr. WICKWIRE. I object to that as immaterial and purely speculative.

The WITNESS. I will be very glad to try to answer the question.

The COURT. I will sustain the objection.

Mr. NEEDHAM. I will withdraw the question if it is objected to.

By Mr. NEEDHAM:

Q. Coming now to your disposition of the value of abandoned property, you have stated, as I understand you, that in your view it is a question of business policy whether the reproduction value, less salvage of abandoned property, should be retained in the property account?—A. Yes, sir.

Q. And that that business policy, in your opinion, should be largely determined by the fact that the company could earn sufficient net revenue to pay a return upon it?—A. Yes, sir.

Q. The result of that policy is to inflate the property account to the extent of the reproduction value of the abandoned property, is it not?—A. That is your statement, not mine. I could not follow you in that to that conclusion.

Q. You object to the word "inflate"?—A. I most certainly do; yes, sir.

Q. I will use the word "increase." It would increase the property account to the extent of the reproduction value of the abandoned property less salvage?—A. That is correct.

Q. The result of such a business policy would be to capitalize that increased amount for all time?—A. By the term "capitalize," just what do you mean?

Q. The right to earn an income upon it.—A. Then I would say yes.

Q. The result upon the public then would be that for all time the public is to be charged rates sufficient to pay an income upon this increased property account?—A. I think that is entirely proper, and I think that the public would gladly do it.

Q. Is it the result? I am trying to get at the result. That would be the result, would it not?—A. Not necessarily the result. If we could make our own schedule of rates and we had no competition which controls, it might possibly be, yet the element of competition might come in and we might not get the full value that we thought we were justly entitled to.

Q. If that was the method of classification the claim would always be made by the company that it had the right to earn an income upon that sum, would it not?—A. Yes, sir.

Q. And the contention would be that rates should be maintained sufficiently high for all time to pay an income upon such increased cost?—A. That is correct.

Q. If the value of abandoned property is charged as depreciation into operating expenses and scattered, if necessary, over a period of years, the amount to be paid by the public in rates for that depreciation is confined to the period of time covered by the repayment, is it not?—A. I do not follow you regarding your use of the word "depreciation."

Q. We will come to that in a few moments and we might differ about the interpretation of the word. But you understand what I mean by the use of it, I think.—A. Taking it in that broad way and trying to meet your view, I should say yes.

Q. I will come to that other question in a few moments.—A. I hope you do.

Q. It is a question of public policy, then, is it not, whether the public shall be charged for all time with rates sufficient to pay an income upon the amount or value of these abandoned pieces of property, or whether the public shall be charged for a limited time for the payment or repayment of these sums?—A. The question is just a little broader than that.

Q. I mean so far as the public is concerned.—A. So far as the public is concerned, the question is just a little broader.

Q. Very well; state it as you view it.

Mr. WICKWIRE. I will have to object to the question, because it seems to me it is calling for a legal conclusion of the witness. He asks whether that is not a question of public policy, and I do not think—

Mr. NEEDHAM. I think you misunderstood. I said "as a question of public policy."

The whole issue, if your honor please, as I understand it, is whether or not the public policy is to be considered or whether the business policy is to be considered. The business policy seems in this particular case to come in contact with what is established at least as public policy. I simply want to clearly define the issue.

Mr. WICKWIRE. I would like to have the question read.

**The Reporter (reading):**

It is a question of public policy then, is it not, whether the public shall be charged for all time with rates sufficient to pay an income upon the amount or value of these abandoned pieces of property, or whether the public shall be charged for a limited time for the payment or repayment of these sums?

**The Court.** The form of the question requires an answer whether or not it is a question of public policy.

**Mr. NEEDHAM.** I will change the form of the question so it will be "as a question of public policy."

**The WITNESS.** Ask me my opinion. That will do.

**Mr. WICKWIRE.** I must still object to the question, because counsel assumes that this is a question of public policy. It seems to me that makes the question as objectionable as it was before.

**The WITNESS.** Could we not overcome it by giving my opinion?

**Mr. NEEDHAM.** To that extent, yes.

**The Court.** I think the witness may answer.

**Mr. WICKWIRE.** We note an exception, if your honor please.

**The WITNESS.** I feel that your question is just a little broader than stated. The main question in which the public is interested is having adequate transportation facilities, and those facilities of the railroad safe for travel. I feel that the matter might be more clearly understood.

So far as these particular pieces are concerned, which I termed the cost of progress, after we have made these changes in our line, the value of our property, the earning value or its ability to do business has been increased to the extent that it at least represents an additional value, a going-concern value, that is equivalent to the amount of money that we put in there; that if the final decision be that, with an investment of \$600,000, we are to be limited to a return on \$200,000, I do not believe anybody would continue us on the board if we continued to make such expenditures as that.

As to my reason for speaking in this way and feeling that it is fair to keep this in capital account and fair to the public, I have this in mind: The expenditure which is made in this connection is made for the benefit of future generations, and the benefit will not accrue solely to the people living in the next five or ten or fifteen years, but it will continue to exist so long as that property is operated, and the people that use that property and get the benefit of the improvement which we make at this time should pay for it. They will pay for that on a return of what we have done for their benefit. It would be unfair, most unfair, for the people for the next five or ten years, to make them not only pay a return, but also pay off this other money which we are asked to charge in the expense account.

**Mr. NEEDHAM.** That is a very good argument on your theory. Now, will you answer my question? Considering all the subjects involved as a question of public policy affecting classification of accounts and payment for abandoned property, it is simply a question whether the public shall be burdened for all time with that cost or shall pay that cost out of operating expenses for a limited time.

**Mr. WICKWIRE.** One moment. I would like to object to that question. It seems to me that that question implies that the determination of this matter is one of public policy, and the question naturally implies that the public or the Government has the exclusive right to determine it if it is a question of public policy. The witness has

already said that he regards it as a question of business policy with the company whether, under such circumstances, they will charge this to profit and loss or whether they will keep it in their capital account. In other words, he thinks the board of directors has discretion in that matter and that it is a matter within the discretion of the company.

Now, the question here assumes that this is a matter not within the discretion of the company or its directors, but that it is solely a question of public policy and it is predicated upon an assumption of something that is not shown here. It also is a question calling for a legal conclusion, and I think it based upon an erroneous assumption. I do not think it is a fair question to put to this witness.

Judge CARLAND. Well, the truth is that the railroad companies and the public are both interested in the way these accounts are kept and neither party is the sole arbiter of how they shall be kept. It seems to me that the question here asked assumes that the Government or its agents has the exclusive right to say how these accounts shall be kept, but the question asked the witness carries with it the idea that, if such things are true, would it not affect public policy? I think you may answer it.

Mr. NEEDHAM. Please confine your answer to my question. I have given you an opportunity to make an argument.

A. Well, as I say, this is new to me.

Mr. WICKWIRE. Please read the question.

The REPORTER (reading):

Considering all the subjects involved, as a question of public policy affecting classification of accounts and payment for abandoned property, it is simply a question whether the public shall be burdened for all time with that cost or shall pay that cost out of operating expenses for a limited time.

A. I do not consider that is the sole question involved.

By Mr. NEEDHAM:

Q. Do you mean to say that you do not consider that that is the only choice which the public has to make in this particular matter?—

A. Yes, sir.

Q. Or do you mean that there are other things to be considered in determining this particular charge?—A. That is what I mean; that there are other questions to be determined than this.

Q. Assuming that there are other questions that influence the public, or Congress representing the public in this case, in determining this question the choice is between those two plans, is it not?—

A. No, sir.

Q. Wait until I get through [continuing]—either charging it to property account, thus capitalizing it for all time, as we have stated, or charging it off to operating expenses either at once or through a series of years?—A. No; there would still be one other.

Q. What other?—A. Writing it off through profit and loss, charging it to your accumulated surplus, in other words.

Q. That would only be done where there was an accumulated surplus?—A. That is quite true.

Q. A general rule applicable to all roads, then, requiring it to be charged to a surplus would not operate as to a carrier where the carrier had no surplus account, would it?—A. I do not imagine that carrier would be undertaking any—

Q. I did not ask you that. Would you mind answering the question directly? The rule could not possibly operate generally.—A. He could still make the charge to this account and afterwards show his deficit that much greater.

Q. But you have just said, have you not, that it should be charged to profit and loss if they had a surplus?—A. No; I did not say it should, I said it might.

Q. It might, provided they have a surplus; but I ask you if that would only apply in cases of companies that had a surplus and you said yes.—A. I do not recall having said yes to that particular question. That was not my intention.

Q. Yes.—A. You could make a charge—

Q. Do you want to change it?—A. If I so made the statement; yes.

Q. Then you would assume that it would be possible for the public to provide that that item should be written off property account and charged to a profit and loss account that had nothing to its credit?—A. It is just the same as you would make any other charge to profit and loss, which, in effect, results in a deficit being shown in your profit and loss balance.

Q. You do not recognize any difference between a company charging to profit and loss its losses, and the public providing for the charging off of an item like the one under controversy, do you?—A. The only reason for charging this off under these conditions would be because you consider it a loss.

Q. Yes; but you do not recognize any difference between this kind of a loss and other losses that go into the profit and loss accounts?—A. Yes; I do, because this is incidental to your cost of property. The other was not.

Q. So far as the public is concerned, do you recognize any difference between this and the other losses incurred by the company in the transaction of its business?—A. Yes; I do.

Q. And you still say, then, considering that difference, it could be charged properly to a profit and loss account that had nothing to its credit?—A. I think that would be within the province of the judgment of the board if they so elected. I do not think they would do it.

Q. In your long statement which you made in answer to one of my questions you spoke of the right of the railroad company to determine these matters for itself. Do you not recognize that the public has the right to determine the reasonableness of the rates charged for services rendered by a railroad company?—A. We recognize that right; yes, sir.

Q. If it has the right to determine the reasonableness of a rate for a service, and the company has the right to insist that they should have a reasonable return upon their investment, or the value of their property, is not the public interested in the value placed upon that property, as affecting the reasonableness of the rates?—A. The entry which you make in your books in this particular—

Q. Well, answer that question.—A. It does not represent value, so that therefore it would not directly have the effect that you referred to. Your cost of the property is not the value of the property as a going concern.

Q. I did not assume that.—A. Well, in order to make the relation between the two, I do not see how you could—

Q. I am asking you whether the public is not directly interested in the value of the property.—A. Yes, sir.

Q. And in the valuations that are placed upon it?—A. In the valuation; yes, sir.

Q. If it is true, then, that in determining the value of the property, the actual cost of any piece of property is an important element and factor to be taken into consideration in fixing the value for rate purposes, is it not true that the integrity of the account which shows this cost is of great importance to the public?—A. I should say yes.

Q. Because it affects the question of valuation?—A. I do not understand that it necessarily affects the question of valuation.

Q. Well, assume then, if you do not understand it, it has been determined that the cost value of an existing property is an important element and factor in determining values.—A. Not the cost value—just the cost.

Q. I say, assuming that. I will discuss the law somewhere else.—A. Well, I say cost, not cost value—the cost. On that assumption my answer would be yes.

Q. Then the public is directly interested in classification, is it not?—A. That is, based on your assumption.

Q. Yes; based on my assumption.—A. But I do not concede your assumption.

Q. Coming now to your objections to charging this wreckage to operating expenses, as an accountant, will you state whether or not depreciation is a charge to operating expenses?—A. What do you mean by "depreciation"?

Q. I have not got to that yet.—A. Well, I cannot answer the question without understanding the full meaning you have of the word "depreciation."

Q. There is such an item in accounts as depreciation, is there not?—A. There is at the present time; yes.

Q. Is it proper and is it customary to charge depreciation to operating expenses?—A. It is proper to charge to operating expenses.

Q. Just answer my question. You are on cross-examination now.—A. I have to divide that in two parts.

Q. No; you do not have to divide it at all. "Depreciation" is a word that has a definition.—A. All right. Then, under the present definition of depreciation, as set forth in their accounts, I would say not.

Q. I did not say depreciation as defined in anybody's accounts. I asked you whether or not, as an accountant, the item of depreciation is chargeable to operating expenses?—A. Depreciation, when restricted to deterioration due to the use or wear of the property, is properly chargeable to operating expenses.

Q. You are now undertaking to define the word "depreciation"?—A. I certainly must understand the word in order to make a reply.

Q. Well, I ask you now again whether or not it is not a general rule of accounting, a fundamental rule, that "depreciation" properly defined is chargeable to operating expenses?—A. I would say no.

Q. Where an engine has become unserviceable for a given road for any cause, and it has to be repaired or abandoned and scrapped.

what disposition is made in the accounts of the value of that abandoned engine?—A. It is charged to operating expenses, less salvage.

Q. Where a bridge over a stream has become for any reason unusable in the future and has to be abandoned, what do you do with the item of the abandoned bridge?

Mr. WICKWIRE. I object to that question because it says "for any reason," and there are various facts dictating different treatments, think the question is too indefinite.

Mr. NEEDHAM. I think you can trust your witness.

The WITNESS. Thank you.

Mr. WICKWIRE. I would like to have the question properly framed.

Mr. NEEDHAM. I prefer to put it just as I have put it with reference to the engine.

Judge CARLAND. I think he may answer the question.

The WITNESS. This is the answer to the question with regard to the bridge.

By Mr. NEEDHAM:

Q. Yes, A. If the bridge is abandoned and not replaced the commission's order—

Q. I do not ask you now what the commission's order is; I know what the commission's order is, and it is in evidence here. We do not need to prove that. I want to know what you, as an expert accountant, what you do with that item? A. That is, exercising my own judgment?

Q. Yes; as an expert accountant. A. Yes, sir. If the property were abandoned and not replaced, I would charge it to profit and loss. If it was incidental to the cost of progress, I would charge to operating expenses such amount as reflected the amount necessary to spend on that bridge to bring it up to its original efficiency. Any amount beyond that, less salvage, I would consider was a question of policy as to whether or not it would be left in the capital account or handled otherwise, and that would depend on the conditions surrounding the case at the time.

Q. You would consider it, then, as a business proposition for the administrative side of the corporation to determine?—A. Yes, sir.

Q. And not an accounting proposition?—A. No.

Q. An accountant's proposition, I mean. A. No, sir. The true function of accounts is to reflect what has taken place.

Q. What is the true function of a balance sheet? You have given me the function of accounts. —A. It is to show the investment in the property and the owners of the property; in other words, all of the assets and liabilities, and the balance indicates the accumulated surplus.

Q. Would you include under that the income and expenses showing a proper balance of the revenues and operating expenses? A. The operating revenue and expense accounts are closed at the end of each year. They are the measure of the earning capacity of the plant for that period only, and at the end of the year they are carried forward until they get into your profit and loss balance.

By Mr. WICKWIRE:

Q. You mean not the entire, but the net result is carried forward?—A. No; but you may have other classes of income; you have charges against income, and the net profit or net income goes into

profit and loss account, and on the other side it can be reflected in various items. It depends on whether that comes in whether it remains in your possession as cash, or it might be accounts receivable. It may be in other things.

By Mr. NEEDHAM:

Q. The balance of the operating revenues depends, of course, upon the classification of items which go into the operating expenses?—A. Yes, sir; that is what we term the net earnings.

Q. The net earnings?—A. Yes.

Q. If current items have been omitted from the operating expenses, then the balance of net revenues would be inflated?—A. I can see a condition under which they would not.

Q. You do not want to answer that question in any other way, as an expert?—A. Yes; I would like to qualify that. If the preceding year had its full charge for operating expenses, and yet the property was fully maintained when you came into the current year, and then this result happened at the end of the year, I would say your net earnings would show greater than they properly should.

Q. It becomes, then, a very important question to classify the items that go into the operating expenses?—A. That is correct.

Q. Take the question of the engine that has become, for any reason, unserviceable, and had to be scrapped. You stated that should go to operating expenses. If that item were left out of the cost here it would, to that extent, inflate the net revenues, would it not?—A. I stated, under the commission's order, it would go to operating expenses. I did not say, as an accountant, that that was my best judgment, as I recall the answer.

Q. Do you wish now to modify your answer and say you would put it into the operating expenses, because the commission's orders had put it there?—A. What I intended to say, if I did not say it, and what I would like now to say, is that if I had the engine to handle I would do identically the same as what I outlined for the bridge. I would charge to my operating expenses any amount necessary to make repairs to bring that up to its original efficiency, as a proper charge to operating expenses. Any amount over and above that, less salvage, I would consider was a question of policy as to whether or not it should be continued in the capital account.

Q. You would apply that to all equipment; you have applied it to an engine, and you would apply it to all equipment?—A. I would apply that, following along the rule which I outlined with reference to its effect on the net earning capacity of the plant as a whole. That is my guide in reaching my conclusion with reference to the proper capital charge.

Q. It would not only affect the operating expenses, but also the property account.—A. It would affect the operating expense account and the income account and the property account.

Q. Now, as I understand you, you would apply your method to the roadbed, fixtures, and equipment; you would treat them all alike in that regard.—A. I see no difference in the fundamental principle involved.

Q. From your standpoint, then, the treatment of equipment or movable property differently from the treatment of permanent property, generally spoken of as the roadbed, is artificial.—A. It



as the result of a compromise with the Government's representatives. It was not done as a matter of principle.

Q. Did you state that you were a member of this committee of twenty-five?—A. Yes, sir.

Q. When you spoke of a compromise, did you mean the negotiations that went on between the commission and this committee?—A. Yes, sir.

Q. Coming back to the property account again, assuming that Congress has declared that one of the items of accounts in the records kept by the Interstate Commerce Commission shall be the actual cost of existing property—now, assume that as the law—of an existing bridge is too weak to carry the future traffic, and it is strengthened by adding iron and steel to it to the extent of \$50,000, the law would be complied with by adding the \$50,000 to the property account, would it not, as the existing bridge includes the old, with the addition put upon it?—A. If Congress passed that act and that proposition was put up to me, I should ask the court to pass upon it.

Q. I did not ask you what you would do. I asked you if the fact that the existing structure was constituted of the old bridge and the additional material put into it, amounting to \$25,000, the addition of \$25,000 to the property account would be proper as showing the actual cost of the existing property?—A. That was the actual cost of doing it in a piecemeal way; yes, sir.

Q. Yes; but that would represent the actual cost of the bridge, would it not, as existing after the betterment had been made?—A. In piecemeal construction; yes, sir.

Q. Now, if instead of doing that, the old bridge were taken down and removed, scrapped, and had cost originally—or its reproduction alone, to put it that way—was \$100,000, and it was scrapped for 10,000, that is, \$10,000 salvage, and a new bridge, sufficient to carry the traffic was placed over the stream in place of the old one, at a cost of \$125,000—A. The first was how much?

Q. The first was \$100,000, with \$10,000 salvage.—A. I see.

Q. (Continuing.) Was put over the stream at a cost of \$125,000, and you, as an accountant, were called upon to give the exact cost of the new structure, what would you say the present cost of the existing structure was?—A. Well, I would not, in order to get that, use the present cost of reproduction, because that cost might be with the increase in labor and material in excess of its original cost to the company, but I would feel that the actual cost was the original cost, less the salvage, plus \$125,000, if that change was made incidentally to the cost of progress.

Q. I did not ask you how you would feel about it. I asked you what the actual cost of that new bridge would be.—A. That is what the actual cost would be.

Q. And you state that as an accountant?—A. Well, I will qualify that to this extent: The bridge is a part of my total structure, and considering it as a whole, that is a part of the cost that goes to make the total structure what it is to-day; that is, my real estate and all, that is what it cost me to get it as it exists to-day.

Q. As an accountant, then, you would say that the actual cost of the new bridge was \$125,000, plus \$90,000?—A. No, sir.

Q. Well, tell me just how you would—A. I differentiate as between the present cost of reproduction, which you place at \$100,000, and the original cost of the property. The original cost may have been only \$75,000.

Q. I do not care to go into that question, and therefore I will change the proposition and say the original cost of the old bridge was \$100,000, and the salvage was \$10,000, and the price paid for the new bridge was \$125,000—A. Yes, sir.

Q. What, as an accountant, would you state the cost of that bridge to be—not its value, not its investment, but its cost?—A. The cost to us of getting it there was the total of the two, less salvage.

Q. I ask you now, as an accountant, to state what the cost of that new bridge is.—A. That is what I meant by my answer.

Q. No; answer that question direct, please.

Mr. WICKWIRE. He has answered it.

Mr. NEEDHAM. No; I think not.

By Mr. NEEDHAM:

Q. Put it in figures, and tell me what it is, now, as an accountant,—

A. The original cost was \$100,000—

Q. And testify under oath as to what that bridge cost.—A. The original cost was \$100,000?

Q. Yes.—A. I am testifying now to cost and not value?

Q. Cost and not value, cost and not investment, but the cost of the new bridge.—A. I would say the new bridge cost what we paid for it, \$125,000.

Q. Did it not cost any more than that?—A. The new bridge cost \$125,000, considered by itself.

Q. Well, did it cost that?—A. The new bridge cost that; yes, sir.

Q. If you got \$10,000—A. That has nothing to do with the purchase price we paid for this bridge.

Q. Then it is simply a question of the cost.—A. That is just taking that one bridge by itself.

Q. Yes; I am taking that bridge by itself. Now, if you had beside the bridge—approaching the bridge—a mile of line road on an embankment, and that embankment was washed away, and you had to renew the embankment, and to renew it, it cost you \$125,000, what would you say, under oath as an expert, that the cost of that new embankment was?—A. It would depend on the conditions under which it had washed out. If it washed out during the construction, then the total cost of that embankment was the cost of the original plus the second one.

Q. I did not say it washed out during construction.—A. Well, but—

Q. I asked you if you had in operation a line of road. That is not construction.—A. That would depend on whether I had a reasonable earning on the old line. If I had not—

Q. What has that to do with the cost of the embankment?—A. I would consider it as analogous to the construction period.

Q. However you consider it, what I want to get at is, what would you say that the new embankment, for which \$125,000 had been paid out, cost?—A. I would say it really cost us the sum of the two.

Q. You would say that under oath, would you—that the cost of the new embankment was the cost of the two?—A. The cost of the new embankment by itself was simply what it cost.

Q. Yes. Is that your answer?—A. When considered in connection with the old one, then I would say that the cost to us was the sum of the two.

Q. You mean that you had invested in that particular mile of road, at different periods of time, the cost of the old and the cost of the new?—A. That is right; yes, sir.

Q. The cost of the existing embankment would be its actual cost, however, would it not—\$125,000?—A. I see you make a distinction between cost and investment?

Q. Yes, sir. A. Yes, sir. Then, I would say the cost of the second as the sum you stated, under those conditions.

Q. It must be true, then, that if the law requires such a classification of accounts as will give the cost of existing property at a given time, all investments which had theretofore been made, represented in structures or equipment which are abandoned, scrapped, or destroyed, must be the actual investment for the new property; is not that true?—A. We do not have that condition confronting us.

Q. I did not ask you that. Is not my proposition true?—A. Read the question.

The REPORTER (reading):

It must be true, then, that if the law requires such a classification of accounts as will give the cost of existing property at a given time, all investments which had theretofore been made, represented in structures or equipment which were abandoned, scrapped, or destroyed, must be the actual investment for the new property; is not that true?

A. You use both the term "cost" and the term "investment."

Q. I use the term "investment" with reference to the abandoned property only. I use the word "cost" with reference to the new structure.—A. Well, then, that should be the cost of the old rather than investment.

Q. Well, the cost of the old. I use the two words.—A. Based on our assumption my answer is yes.

By Mr. WICKWIRE:

Q. You mean exclusive of abandonments properly chargeable to operating expenses?—A. This is simply taking the question of cost as distinctive from investments.

By Mr. NEEDHAM:

Q. I am dealing with the property account. I am not saying why it should go out; I am just saying what the property account should show.—A. No; not what the property should show. That was not in the question.

Q. With reference to the cost of the property. No; I did not ask you.—A. No; that is quite a different thing.

Q. I was merely answering counsel. I ask him these questions as affecting our theory of the property account, not as affecting operating expenses.—A. I would like to see if I perfectly understood your question. My understanding was that, assuming that a rule is adopted which we must absolutely follow, then what am I to show? necessarily must make my answer in accordance with that particular rule.

Q. Certainly.—A. That is simply a theoretical question, that is all.

By Mr. WICKWIRE:

Q. Yes; but what I want to get at is, when stating that all property, though abandoned, is still to be carried in the property account, you did not include or have reference to property which was abandoned before it was entirely used up, and was therefore chargeable to operating expenses?—A. No.

Mr. NEEDHAM. No; I did not ask that at all.

A. This question is simply a theoretical question, and does not affect the questions involved here, a difference in conditions that does not exist, and simply what I would have to do if I were obliged to make an entry in accordance with such a rule.

Mr. NEEDHAM. That will have to be determined later, when we get before the court.

The WITNESS. Yes, sir.

By Mr. NEEDHAM:

Q. Coming now to the word "depreciation," which seemed to cause some uneasiness—A. No uneasiness.

Q. What do you define "depreciation" to be, generally, now, and without reference to any particular rule, but speaking as an accountant; what do you define "depreciation" to be?—A. I know what others define it as.

Q. I do not ask what others define it. I ask you to define it. You say you are an expert accountant?—A. I did not say I was an expert accountant. I said I thoroughly understood railroad accounts.

Q. Well, I admit that you are an accountant. Go ahead now.—A. My understanding of the term "depreciation"—

Q. As applied to railroad property.—A. As at present applied—

Q. No; I am not asking you about the time now. I am asking your definition of a word used in accounting and applied to the business equipment and plants.—A. As applied to railroads, I would say it is a misnomer.

Q. You do not think they have depreciation?—A. Yes; they have appreciation.

Q. Are you speaking of the stock market, or the physical property?—A. I believe I qualified before as a railroad man and not as a market manipulator.

Q. Well, don't you concede that there is any depreciation of railroad property?—A. Not if they are properly maintained; no, sir.

Q. Well, why is maintenance necessary if they do not depreciate?—A. So far as I would go in the definition of "depreciation," it would be that your property, if there is any depreciation, it only represents the amount which is necessary to bring your property up to its original efficiency; that is, it is a failure to properly maintain your property, and it represents that amount, whatever that may be.

Q. It is a failure in the past in regard to the depreciation that has been going on?—A. It is which?

Q. I say, does it make any difference whether it is taken care of in the past or in the present? The deterioration which has required maintenance is depreciation, is it not?—A. No, sir. If you take care of your current repairs, fully maintain your property, then the deterioration is not there; you have taken care of it through repairs, and you cannot make a double charge of repairs and depreciation to cover the same item.

Q. Do you repair property that is not depreciated?—A. I would say no.

Q. Well, then, there is depreciation, is there not?—A. Well, that is current, and your current repairs take care of it.

Q. Well, we have gotten a little ways on the definition. Won't you follow it up by telling me what you mean by "depreciation"?—A. I answered that question.

Q. I want you to answer that again.—A. I will be very glad to. My answer as to "depreciation" is that it represents the amount which is necessary to expend in repairs to bring the efficiency of your plant up to its original standard.

Q. The depreciation which comes from that wear and tear of the use of the property you would call depreciation to be repaired and charged to operating expenses, would you?—A. I do not call it depreciation. I simply call it repairs; that is, the accounting of it, I mean. I account for that under repairs. I do not account for it under depreciation.

Q. You would call that depreciation, if you had to use that word?—A. If I were compelled to use the word, I would see no particular objection to calling it depreciation as representing what I stated.

Q. Now, we have made a little further progress. Suppose you had to replace an engine that was destroyed in a wreck by a sudden accident, would you call that depreciation, if you had to use that word?—A. I should say so.

Q. And the cost of replacing that engine you would charge to operating expense?—A. Less the salvage.

Q. Less the salvage?—A. Replacing it in kind.

Q. Yes. Suppose a bridge were washed away by a freshet and had to be replaced, would you call that depreciation?—A. I am not entirely sure that I would. I would consider it, however, as one of the hazards of the undertaking, and one that must be met through the expense.

Q. What is the difference between the case of the bridge and the case of the engine?—A. I was going to say, I was leading up to that, and, for that reason, I would see no particular objection to throwing them both in the same class, under those conditions.

Q. You would then call the bridge depreciation?—A. No; I would not call it, but I am willing to let that term apply to it.

Q. You would apply that to the bridge?—A. I would call it an accident.

Q. The same as you would apply it to the engine?—A. Whatever term you use, I would apply it the same; yes, sir.

Q. Suppose that the freshet washed away, in addition to the bridge, a mile of embankment and roadbed, and that had to be replaced; would you call that depreciation, by sudden accident?—A. I fear that my good nature has conceded too much, so far as the hazard in connection with an accident over which we had no control, is concerned. In the case of the locomotive, we had control of the operations, and, to some extent, it was probably our error which was our undoing. So far as the bridge is concerned, that is the action of the elements, over which we have no control, and I would say it would depend entirely on our conditions, or the conditions of the particular

company affected, as to whether that was something for which it should stand the sole expense, or whether it could properly ask the public to incur a part of that expense.

Q. If the company was poor, you would not call it depreciation; if it was rich, you would call it depreciation? A. No; that is not the question. I feel that a company which is rich can adopt a conservative policy, which another company is not at liberty to adopt, just the same as a person buying a suit of clothes necessarily must make his expenditure with reference to the amount of money he has in his pocket or credit to command.

Q. You stated a short time ago that in the treatment of these accounts you would make no distinction between movable equipment and permanent roadbed or fixtures? A. I did not make that statement.

Q. Do you want to change that answer? A. I did not make that statement.

Q. You did not? A. No, sir.

Q. Well, the record will show. A. I should be very glad to make my point clear there.

Q. If a new track had been built and used for several years, then renewals of ties and rails are required, state whether the ties and rails in such track may not be properly regarded as being in a depreciated condition prior to renewal. A. I said that with reference to all property. That comes within the definition I gave for depreciation.

Q. If a new road has been operated for several years—I mean a road in new territory—and there has developed unexpected new traffic, requiring heavy equipment to carry it, the old equipment being inadequate to take care of the new business, would you say that this was depreciation? A. Not at all; no, sir. You might continue your old equipment in use as well as the new.

Q. I say, assuming that the traffic developed required new equipment? A. You do not assume that the old, however, goes out of service?

Q. Well, I will assume that, for your benefit. A. Then, I would answer as I did once before. In the first place.

Q. I do not ask you now how you would deal with that proposition. I ask you if you would call that depreciation? A. I would then answer as I did before, that the amount necessary to spend on that equipment to bring it up to its original efficiency, I would bring within the term depreciation.

Judge CARLAND. We will take a recess here until two o'clock.

Whereupon, at 12:30 o'clock p. m., a recess was taken until 2 o'clock p. m.

AFTER RECESS.

WASHINGTON, D. C.,

Wednesday, December 11, 1912—4 o'clock p. m.

WILLIAM H. WILLIAMS, the witness on the stand at the time of taking the noon recess, resumed the witness stand and testified further, as follows:

Cross-examination (continued) by Mr. NEEDHAM:

Q. Mr. Williams, do you recognize in your expense account—as an expert accountant, I mean now—any items that are the result of de-

preciation caused by inadequacy of either rolling stock or road-bed?—A. I would recognize that by treating it as cost of progress, the understanding being that that inadequacy is not due to wear and tear.

Q. I used the term as applied to any facility used as a part of the transportation, either roadbed or rolling stock, that has become, as was expressed here by a witness, inadequate to do the business of the road. In treating that inadequacy or any item growing out of the changes in equipment or structure to meet that inadequacy, would you place any items whatever in your operating expense?—A. The wear and tear portion—that is, to the extent that the inadequacy was due to wear and tear in connection with the creation of revenue—I would consider it a proper charge to operating expenses.

Q. Assuming a case where a railroad company looked forward ten years to the absolute inadequacy of its road to carry the traffic then being developed, it begins improvements to meet that inadequacy by changing its equipment, changing its line to carry the new equipment, reducing its grades, taking out its curves, and in that process instrumentalities are discarded and no longer used. What would you do with such items?—A. To the extent there was any element of wear and tear, I would consider that a proper charge to operating expenses. Beyond that, I would regard that a question of policy for the management to determine, and as an accountant I then would reflect the policy of the management by recording the fact in the account to show just what had taken place as a result of the policy which the management had outlined.

Q. That is, disregarding, of course, any rule of law requiring any particular classification?—A. I should presume that the instructions issued—rather, I take it that my responsibility as an accountant is to the management of the property—that is, to the board of managers and the stockholders—and that they would not ask me to do anything which was not in accordance with the law.

Q. How would you treat expenses incurred to meet depreciation by obsolescence?—A. I would substitute for obsolescence cost of progress and handle it as I have already testified.

Q. How do you define obsolescence as applied to railroad property?—A. I define it by calling it "cost of progress."

Q. Can you give any further definition of it that would enable me to identify any particular instrumentality?—A. I would say it was the withdrawal which was incident to and necessary or economical in connection with the increased efficiency of your plant beyond the present efficiency of your plant at the time it was constructed and its cost incurred.

Q. Your plant would include the new machinery, new construction set in the arts?—A. Yes; I consider that is cost of progress.

Q. That would be your definition of obsolescence?—A. Yes, sir.

Q. You would then treat what I designate as "depreciation from wear and tear and sudden accidents" differently from what you would treat depreciation from inadequacy and obsolescence—in the accounts, I mean?—A. I would make the three classifications. There is the one which you term obsolescence. There is the accident, which is incidental to the transportation and one of the hazards of the undertaking and possibly due to the management or within our con-

tool, such as the wreck of a train, and the accident which you referred to as a washout, which was beyond our control and due to the action of the elements.

Q. You said obsolescence, you mean " sudden accident " — A wash-out has nothing to do with obsolescence, has it? — A. I was using your term " obsolescence," which I term " out of progress," in which you term the development of the art. I was making that distinction with reference to obsolescence.

Q. You stated this morning with reference to some of these items, the classification of which you said was in your judgment, a matter of business policy. Now, it would differ as between rich roads and poor roads. What did you mean by that? — Please explain that a little more fully. — A. I meant that there being a question of policy when the problem of management is decided, I presumed a management might bring a decision in such case which it would not bring in the case of a business policy to make in another case.

Q. Taking the item of depreciation from consideration, do you think the law is the same as to the difference between a rich road and a poor road?

A. I am not regarding depreciation as a matter of policy, but as a matter of business policy, and that is my belief.

Q. In this regard, is the depreciation of a road a matter of business policy, or is it a matter of policy as to the different treatment of items of depreciation? — A. I am not sure, but I am not sure that it is a matter of business policy, but I am not sure that it is a matter of policy as to the different treatment of items of depreciation. I am not sure that it is a matter of business policy, but I am not sure that it is a matter of policy as to the different treatment of items of depreciation.

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pany, and I do know of cases of that kind where between the two parties items of this kind have been regarded as improvements.

Q Are there instances where they have not been regarded as improvements, but have been charged to operating expenses?—A I have never had any personal experience with such items being charged to operating expenses. I do not know of any.

Q You only know of cases where they have been charged to improvements?—A Yes, sir. I am talking of properties with which I have been associated and of which I have some knowledge.

Q Do you know, outside of the cases of leased property, whether there is or was, before this rule was adopted by the Interstate Commerce Commission, a difference in treatment of the item of cost of reproduction of abandoned property?—A I have no personal knowledge of it.

Q You are a member of this committee?—A Yes, sir.

Q Was not that subject discussed in that committee?—A That subject was discussed, yes, sir.

Q Was there not brought to the attention of your committee practices of different roads as evidence of the proper treatment of that item?—A I could not say offhand. My impression is it may have been. I am ready to say it may have been, because usually we did undertake to set forth our various practices.

Q Would you say that there was a difference between roads in the treatment of that item so far as the property account is concerned?—A I would neither say that there was nor was not.

Q You heard Mr. McCarty's testimony this morning. I should have called his attention to these items.

This (indicating) is your annual report?—A That is the annual report of the Kansas City Southern Railway Company, yes, sir.

Q For 1913?—A For the fiscal year ended June 30th, 1913.

Q And to which Mr. McCarty referred this morning?—A Yes, sir.

Q There are two or three items in this report bearing upon testimony already given that I should like to have you read into the record, which I have indicated beginning with one on page nine. Will you just read that to the reporter?—A The extract is from page 9.

The decrease in the lumber receipts and the extremely unfavorable weather in the lumber districts, and also the dependence of reconditioning freight cars in the South, probably amounted to \$420,000, which under ordinary conditions will naturally be required. The substantial decrease due to the construction of pipe lines was \$495,000, which can be required only by the development of new oil fields.

Q On page 11 read the paragraph I have marked there.—A (Reading.)

The management believes that the development of the Gulf ports and the further development of the territory tributary to our road will soon bring about a satisfactory increase of business and the equalization of traffic.

Q On page 13 read the concluding paragraph of the report.—A (Reading.)

The form of balance sheet prescribed by the Interstate Commerce Commission has been filed with that Commission at Washington. Your board has deemed it advisable, however, to retain herein the form of balance sheet heretofore adopted, since the stockholders are familiar with the same and since it is believed to set out more clearly the financial condition of your company.

Mr. NEEDHAM. I think that is all.

## Redirect examination by Mr. Wickwire:

Q. You were asked on cross-examination some questions that assumed that the sections of line the use of which was discontinued as an incident to the grade reductions involved in this case were to be treated as property abandoned. Will you state what your view is in regard to the use of that term and in regard to the essence of the matter as to whether there is an abandonment or not?—A. I thought I had made myself clear on that in the cross-examination in stating that my opinion was that that should be termed "cost of progress." In considering these questions I look at the whole property as a going concern and that this change which was made brought about an improvement to the property as a whole and enhanced its value.

Q. In the treatment of these questions do you regard the entire railroad plant as one entity as distinguished from a portion of disconnected or separate segments of road?—A. I do, feeling that no property has value without the right of use, and if these were simply sections of property of such nature that they could not be used they would have no value of any kind. It is only when you can create a use for those that you obtain any real value to them.

Q. So that a small section of track, or a mile or two of track, successive pieces, separately considered, have little if any value?—A. I should so consider it.

Q. And that the value to be taken into consideration is the value of the entire line, with all of the equipment that is used in connection with it, and that the entire plant should be considered in its entirety?—A. That is my opinion; yes, sir.

Q. You were asked some questions as to whether a charge could be made to profit and loss unless the corporation had a surplus. Assuming, as implied in the questions which were asked you, that the corporation had in fact sustained a loss, would it not be proper accounting and would it not be absolutely necessary as a matter of correct accounting, to have that loss reflected in the company's accounts, and would it not ultimately appear in the profit and loss account?—A. Yes, sir.

Q. Will you explain that, please?—A. The operating account and the income accounts are closed out at the end of the fiscal period and the general practice is a period of twelve months or a fiscal year. Whatever balance there be, whether it be as loss or profit, is carried forward into the profit and loss account. If it be a loss, your profit and loss balance necessarily is reduced to that extent. If it is a profit, your profit and loss balance is increased by the amount, assuming that there was a credit in your profit and loss account. If, on the other hand, there was a deficit in your profit and loss account when you carried forward a loss, it increased that deficit.

Q. If a loss, we will say, of \$100,000 had in fact been sustained by the corporation during this past year, that loss would inevitably be reflected, would it not, in the company's profit and loss account, whether it were carried directly to the profit and loss account or whether it were first taken out of the earnings and then the net amount of the earnings carried to the profit and loss account?—A. In either case your balance would be affected the same.

Q. The profit and loss balance?—A. Yes, sir.

Q. Does not a railroad company have elements of value, such as franchises, etc., which are not represented in the statement of the cost of property?

MR. NEEDHAM. I object to that. That is a question of law as to whether or not that is an item upon which they can base the fixing of rates. It is an open question that has not been yet determined. Of course, we all know there are franchises belonging to railroads. There is no doubt about that; but whether they are reflected in the accounts depends entirely upon whether a railroad has undertaken to value its franchise. It is very true that railroads are taxed by the States, in some States, upon the value of their franchises. It has been held by the Supreme Court that if a franchise is taken away from an operating company, it must be valued and paid for. I recognize these facts. But it does not affect this question of accounting one way or the other, as I view it.

MR. WICKWIRE. If counsel will admit the fact upon the record, it will be unnecessary for the witness to answer the question. Do I understand that is admitted?

MR. NEEDHAM. What?

MR. WICKWIRE. The fact that there are elements of value which a railroad company may have in the way, for instance, of value of franchise, which are not shown and reflected in the statement of the cost of property.

MR. NEEDHAM. I admit that there are franchises, and that they are valuable, and that in some cases they do not appear and may not appear in this case; I do not know, but I do not think that that affects this question or the issue in this case as to the distribution or classification of the items of abandoned property. If what you mean to say is that the railroad company has a franchise and in this particular case it does not appear in their property accounts, I do not object to that fact, although we are getting into an issue that is not involved here at all.

THE COURT. I will sustain the objection to the question.

MR. WICKWIRE. We note an exception.

By MR. WICKWIRE:

Q. You were asked on cross examination some questions as to how you would treat the cost of a new bridge, under the following circumstances: Assuming that there was already a bridge which had cost \$100,000 and that it could be removed and scrapped, and that there would be a salvage of \$10,000, and that a new bridge would be constructed at a cost of \$125,000 to carry increased or heavier traffic. You stated, as I recollect, that you would allow the original cost to stand in the property account, and that you would add to the property account the cost of the new structure, \$125,000, less the salvage. That is correct, is it not?—A. I did not state that I would do it. I stated that I thought that was optional with the management, and that it was permissible and right to do it.

Q. That that was a proper practice?—A. Yes, sir.

Q. The amount which would then stand in the property account would be \$215,000, would it not?—A. That is assuming that the first bridge had been fully maintained; yes, sir.

Q. Assuming that that original bridge were left there, and that it could be strengthened by the addition of other material at a cost of \$115,000, that additional cost of \$115,000 would, under the regulations of the Interstate Commerce Commission, be chargeable to capital expenditure, would it not?—A. Yes, sir.

Q. And upon those assumptions the net result in the amount which you carry in your capital account would be identical?—A. That is correct.

Q. If, however, the bridge which was removed had depreciated in the sum of \$50,000, you would then make a charge against operations of \$50,000 to represent the wear and tear of that bridge?—A. Yes, sir; to represent the wear and tear.

Q. In that event, the total cost in case a new structure were added would be \$50,000 less?—A. Yes, sir.

Q. And that would make a total of \$165,000 which would stand in the capital account in respect of a bridge?—A. Yes, sir; as representing the investment—my reason for that being that that investment there was necessary in order to get a fuller use of the rest of the property.

By Mr. NEEDHAM:

Q. I understand that hypothetical case of yours to mean that the new material that went into the bridge cost \$115,000.—A. That is, including the labor.

Q. The total cost represented in the new additions \$115,000?—A. That is right.

By Mr. WICKWIRE:

Q. Assuming there had been this depreciation of \$50,000, and that therefore the total amount in the property account, if the new bridge were erected, would be \$165,000, then if the amount required to strengthen the bridge so that it would be as good as a new and a heavier bridge were \$65,000, the total amount which would stand in the capital account would be the same, namely, \$165,000? Is that correct?—A. I did not quite understand the question. Do you refer to a comparison between the new bridge and the strengthening of the old bridge so that the conditions to handle traffic would be identical?

Q. Yes.—A. Then I answer yes, sir.

Q. You were asked on cross-examination whether if a bridge which cost a certain sum of money were carried at that figure in the property account and it was subsequently replaced by another bridge at added expenditure, the cost of the second bridge alone would represent the cost of what physical property the company then had at that time. Is it not a fact that in every railroad there are various items which are carried in the property account which are not represented by any property specifically in existence—as, for instance, scaffold and falsework and other items?

Mr. NEEDHAM. Scaffold and falsework is no part of transportation property. We are talking about transportation property put to the use of the public. You never put scaffold or falsework to the use of the public as a transportation property. It is simply one of the incidents in the construction of property which is put to the use of the public.

Mr. WICKWIRE. It is a part of the cost of the property —

Mr. NEEDHAM (interrupting). It is part of the cost of the property, true.

Mr. WICKWIRE (continuing). — in its present developed state.

Mr. NEEDHAM. No; no part of it whatever. That does not represent anything in the transportation property. It has all been swept away, but it was part of the cost of construction. The issue in this case is the cost of the property put to public use, which is the transportation property only.

The WITNESS. This is a part of the cost of that property which was put to public use. Without the erection of the falsework you could not have had a bridge which was devoted to the public use.

Mr. NEEDHAM. It is not material.

The COURT. I cannot see that it is material or relevant. However, you did not object to it; you merely talked to counsel.

Mr. NEEDHAM. I know I did. I do not like to object, because I want to get along as rapidly as I can. There is no question but what in construction there are a lot of things done that do not enter into and become a part of the transportation of property.

The WITNESS. There is one thing in the statement as I understood it to be made by counsel. You refer to the question of cost of the two, and that one costs more than the other. The determining factor was not the cost, but was the capacity and value.

By Mr. WICKWIRE:

Q. Do you understand, Mr. Williams, under the regulations of the Interstate Commerce Commission, in case a property has become inadequate for present needs, not owing to any defect in the property, but owing to the greater volume of traffic which the development of the company imposes upon the road, that it would be proper to build an additional track and to charge substantially the entire expenditure to capital account? — A. That is correct.

Q. If you get the same result of largely increasing the capacity and efficiency of the line by a reduction of grades, and certain of those grades are made upon adjacent territory by relocations of parts of the line, do you know of any reason why the expense of obtaining the improvements and the increased efficiency in that manner should not also be chargeable in its entirety to capital account? — A. I do not.

Mr. NEEDHAM. He has answered that question once on direct examination.

By Mr. WICKWIRE:

Q. Under the act to regulate commerce, section 20, there is a requirement that the accounts shall show the cost of property. Do you know of any reason in accounting or anything in the regulations of the Interstate Commerce Commission, aside from those of which we complain in this case, which would interfere with carrying into the property account, if desirable, an item representing what you have called the cost of progress?

Mr. NEEDHAM. I object to that, your honor. That is a construction of the act itself. The act says, "Cost of road." The witness has very clearly pointed out his theory that what he terms "cost of progress" is cost of the road. We say, on the other hand, representing the commission, that the term "cost" as there used means

the cost of the existing property. That is the very issue in this case, and that is a construction which the court is to give to that language in the statute, and not the witness.

Mr. WICKWIRE. I will change the form of the question, if the court please.

By Mr. WICKWIRE:

Q. Do you consider that it would be a proper method of accounting to subdivide the property account in such manner as to show as a separate item what you denominate the cost of progress?—A. I do; yes, sir. I regard that as entirely proper. In other words, I want to make myself clear in that answer—

Q. (Interrupting.) Yes, please explain your reasons.—A. In the first place, the title of the account is "property investment," not "cost." It would be possible to subdivide that property investment account so as to show your investment in the property, which would be found on taking an inventory, and to show your investment in those properties in this class of items which you refer to as cost of progress. That would set them both out clearly on the balance sheet, and there could be no doubt in any person's mind as to what the two meant.

Q. By this method which you suggest, state whether it is a fact that you would preserve a specific record showing what the cost of progress was, and that if it were charged to operating expense from time to time, pursuant to the regulations of the commission or for any other reason, it would be submerged and lost.—A. That is my opinion; yes, sir.

Q. And would not be revealed and properly set forth in the company's account?—A. It would not be set forth in your permanent account.

Mr. WICKWIRE. That is all.

Recross examination by Mr. NEEDHAM:

Q. The process of charging the value of abandoned property, less salvage, to operating expenses is a record of what becomes of that property, is it not?—A. We do not charge the value. We charge the cost of replacement.

Q. Just answer the question, please.—A. It is not a permanent record.

Q. What do you mean by "permanent record"?—A. My impression is. I should like to have a copy of the commission's instructions on destruction of records, so I could check myself on it—that our operating expense account we would not have to maintain forever and retain in our possession. After a time we have authority to destroy certain records. The permanent books of the company are those which contain our capital account. If it goes into operating expense it would not be transferred to your general account. That is what I had in mind.

Q. Is not the requirement with reference to the accounts that the abandoned property shall be figured as a separate item?—A. As a separate item where?

Q. In the accounts which are the records of the financial transaction.

Mr. WICKWIRE. You mean in the operation accounts?

Mr. NEEDHAM. I mean in the accounts kept of the operations of the road.

The WITNESS. It is in your operating account; yes, sir. And, as I say, if I had the commission's instructions on destruction of records, I could refresh my memory on the other.

By Mr. NEEDHAM:

Q. Then when you say "submerged" you mean that, according to your present impression, the record of that particular transaction would not be kept forever?—A. Yes, sir; I think that is quite possible.

Q. Would the record of the property account be kept?—A. Yes, sir.

Q. But not of the operating expense? That is your present view?—A. I know the property account must be kept; yes, sir. I am not entirely clear on the other. That is just my recollection of it.

By Mr. WICKWIRE:

Q. I show you the regulations of the Interstate Commerce Commission relative to destruction of records. A. I find it is not specifically set forth. My impression, looking at the commission's instructions, is that it would come within the seven-year period, for which they say we would have to keep the record.

By Mr. NEEDHAM:

Q. Referring now to the illustration used by Mr. Wickwire, where he said that, adding \$125,000, less the salvage of \$10,000, to the old bridge, would represent an investment of \$215,000 in the bridge existing, in case of an inventory of the property and a valuation as to the cost of reproduction, assuming that the materials and labor had not changed, the cost of reproducing that bridge would be \$215,000, would it not?—A. The cost of reproducing it would be the actual cost of material plus the labor.

Q. Surely, but I am assuming that there was no cost. But, speaking generally, the cost of reproducing that bridge as it existed after the repairs were made would be practically the \$215,000?—A. No, sir.

Q. What would it be?—A. Your figure was \$125,000.

Q. I was using Mr. Wickwire's illustration.

Mr. WICKWIRE. I was using your illustration.

By Mr. NEEDHAM:

Q. The old bridge was \$100,000, with \$10,000 salvage, and the new bridge was \$125,000. Mr. Wickwire assumed to put you this proposition, or did put you this proposition, that the bridge was repaired or increased by the addition of \$115,000 worth of material and labor, making the cost of the bridge actually \$215,000.

I say, after that bridge has been thus strengthened and an inventory is taken of the property for the purpose of arriving at a reproduction value, so called, it would cost \$215,000 to reproduce that bridge, would it not?—A. No, sir.

Q. What would it cost?—A. I could not state definitely, but under the illustration as you give it, that is what we call piecemeal construction. You have to organize your gang in both cases; you have to transport your material there; you have to use cars and other equipment, etc. If you are doing that all as one proposition, you have it only once. In a piecemeal proposition there are certain operations you will have twice. Eliminating that duplication of work, it

would be the \$215,000 less the actual cost of that duplication of work, whatever that might be.

Q. In the case which I put to you, if the old bridge were entirely scrapped and abandoned and the new bridge were put in its place at \$125,000, and an inventory were taken for the purpose of ascertaining the reproduction value, what would be the result then?

A. May I suggest that for the \$125,000 you would not get the same type of bridge you would get for your original plus \$115,000.

Q. I know that. A. It makes a conclusion which is sort of—it makes you, in a way, make a statement which is so contrary to actual conditions and known results that it is rather embarrassing to answer.

Q. Perhaps you forget that I assume that the new bridge would carry new traffic and would cost only \$125,000. A. Then I would say the management never would have spent \$115,000 to rebuild the old one.

Q. I do not think so either; I agree with you on that. Let us assume the case of adding an additional bridge to carry a second track in order to carry the additional traffic. When you come to take an inventory of the property there would be two bridges there instead of one, would there not? A. That is correct.

Q. And the reproduction value would be the reproduction value of the two bridges? A. That is correct—reproduction cost.

Q. Yes; reproduction cost. If, instead of having two bridges, you had put in a stronger bridge to carry the additional traffic, then the reproduction cost would be simply the value of one bridge, would not? A. It would not be the value. It would be the cost of labor and material of actually putting that in there.

Q. That one bridge? A. Yes, sir; that one bridge. That is correct.

Q. That reproduction value would not consider that investment or any investment that had been made before in a bridge which had been abandoned? A. That cost would not represent that; no, sir.

Q. That would be true of roadbed as well as bridges? A. That is correct.

Mr. NEEDHAM. That is all.

Redirect examination by Mr. WICKWIRE:

Q. Mr. Williams, suppose this \$100,000 bridge had deteriorated to such an extent that it was now worth only \$10,000, and that is all that could be obtained for it, and that the \$90,000 represented wear and tear; in removing that bridge and putting in a new bridge at a cost of \$125,000, state just what charges would be made and how the property account would stand in respect to the bridge or the two bridges, if you please, at the end of that operation. A. Under these conditions as you state that proposition, you would charge to your operating expense that portion which represented the wear and tear of the old; that is, what was necessary to bring it up to its original efficiency, \$90,000.

Q. And that amount would be credited to the property account, would it not? A. Not as a matter of fact, because you would simply reduce the amount of the new bridge which you would carry forward to your capital account. You could show a credit to your property account and then add the total cost of the new—either way.



Q. What would be the *modus operandi* of making the further entry?—A. Your new bridge was \$115,000?

Q. \$125,000.—A. You would charge to your operating expenses \$20,000. You would add to your capital account the difference between \$125,000 and the \$90,000, representing the wear and tear on your old bridge, and \$10,000 representing salvage, or a net addition to your capital account of \$25,000.

Q. So that when you get through you would have a bridge which had cost \$125,000 and you would be carrying just the sum of \$125,000 in your capital account?—A. That is correct; yes, sir.

Mr. Wickwire. That is all.

Witness excused.

CHARLES B. SEGER, a witness of lawful age, called by and on behalf of the petitioner, being first duly sworn, is examined.

By Mr. Wickwire:

Q. Please state your full name.—A. Charles B. Seger.

Q. Where do you reside?—A. New York City.

Q. What is your business?—A. Accounting.

Q. Are you employed by any railroad company?—A. At the present time I am the deputy comptroller of the Union Pacific system and the Southern Pacific system, railways embracing about 17,000 miles of line, and in that position have direct supervision over the accounting details of the companies embraced in those systems.

Q. How long have you occupied this position?—A. I have been in the railway service about thirty years.

Q. Will you state what your railway and accounting experience has been?—A. Twenty years of that time have been in official capacities as accounting officer, including eleven years as chief accounting officer of various railways in Texas, six years as auditor of the Southern Pacific Company at San Francisco. In January, 1910, I was appointed general auditor of the Union Pacific system and Southern Pacific system, with headquarters at Chicago, and upon consolidation of the offices at New York I was appointed deputy comptroller, with substantially the same duties that I formerly had as general auditor.

Q. You are then very familiar with accounts?—A. I claim to be.

Q. Are you familiar in a general way with the questions involved in this case?—A. I am in a general way; yes.

Q. Are you familiar with the various regulations and classifications that have been made from time to time by the Interstate Commerce Commission?—A. Yes.

Q. And with respect to the regulations involved in this case?—A. Yes.

Q. Are you a member of the committee on corporate, general, and fiscal accounts of the Association of American Railway Accountants?—A. I am.

Q. How long have you been a member of that committee?—A. Since January 1, 1910, as nearly as I can remember. I entered on that committee when I was appointed general auditor, which was about that date.



there, or whether you switch your line two miles in the opposite direction, when you get through you still have a line between two given points; and, as previously stated, if that misjudgment in location had been discovered before the line was completed—and I might add there that that frequently is the case that such errors of location are discovered—the cost of both lines, or parts of lines, would have certainly been included in the cost of road and franchises of that company; and reasoning on that principle, I can not see that, if the error was discovered later, the same result should not follow.

Q. It appears in the evidence in this case that a line constructed with a view of a maximum grade of one per cent will not coincide except, perhaps, incidentally at some points, with a line constructed upon the theory of attaining a maximum grade of one-half of one per cent. You understand that to be the fact? A. I do. That does not change my view, because you have the line there just the same.

Q. In using the term a moment ago a mistake in judgment in the location of the original line did you mean to have those words understood in that acceptation, or did you mean that in the development of the road it might be necessary to make some changes of location in order to get the proper gradient? A. I used the term "misjudgment" in the broad sense that railroad engineers are supposed to know which is the right thing to do in the first place. The error that I speak of is one that is developed either by experience or by a change in conditions. I did not mean to convey the idea that some body made an error, then the error had to pay for eventually, as it is one of those things that is developed in the conditions of the property.

Q. From the testimony in this case it appears that the line was well located at the time it was originally built, being a line having a maximum grade of approximately one per cent, and that the purpose of such changes has been to get a line having a maximum grade of five-eighths of one per cent, and that is the end which has been attained now, so that upon the evidence in this case there is not involved any error of judgment of the engineers in the original location of the road. Applying that argument to your testimony, in your opinion, would the same results follow? A. Absolutely so. Again, if I may, in being persistent as to my expression of error in judgment which you have explained very handsomely, of course, when they built a line of one per cent grade, there was a reason for it, and there is no doubt they had built the line of one-half of one per cent grade, they could have undoubtedly spent more money at that time to build it—more familiar with the topography or the geographical location of the Kansas City line, but I do know that from actual experience we are built to a higher gradient as a matter of economical construction on account of the scarcity of money at the time the line was built. In later days, when the company is established and has credit of some kind, they undertook to get such a line as they would like to see built in the first place, and if in doing so, it is more economical to make a change in the location, then it is to cut down to an economical grade that which was used in the first place, it does not change the principle one particle, in my judgment, that the entire expenditure is part of the cost of that property.

Mr. Wickwire. You may examine.

## Cross-examination by Mr. NEEDHAM:

Q. A western road, possibly one of your roads, I am not sure, has a stretch of road of some miles, which I will assume is ten miles, built on the margin of a stream. Assume that it costs \$50,000 a mile or \$500,000. It was washed out frequently evidently, and they moved it up the hill and built the road there anew. I assume that the cost was \$50,000 a mile, and afterwards, not finding that far enough away from freshets, it was moved a third time. Those terraces appear there now, although I may not have given the right distances. It was moved the third time and built, I will assume, at a cost of \$50,000 a mile. What would you say the cost of that road is as it stands there now? A. Well, I am not unfortunate enough to own that road, but I happen to believe that I know the road you refer to, and as I understand your illustration, the line was changed twice from the original location at an average cost of \$50,000 a mile. If I was controlling that situation I should certainly insist that the records of the company should show the cost of that railroad as \$150,000 a mile.

Q. For the ten miles? A. Yes; whatever distance that money was spent on.

Q. If you were appraised to value that road and in inventorying it you inventoried those ten miles, and were called upon to give a reproduction value of it, what would you say was the reproduction value, assuming that the cost of constructing it now would be the same as the cost of constructing it before? A. That question is a little involved, and, with your permission, I will answer it with what appears to me to be the same complication. In the first place revaluation of a railroad for

Q. I intended to use "reconstruction value," if that is what you mean by that. A. Well, we will call it "reconstruction value." The reconstruction value of a railroad depends upon a good many conditions that are not reflected in the original construction. For instance, taking one item, if that road was built fifty years ago, when it cost one hundred dollars a ton, and it could be produced to-day for twenty five or thirty dollars a ton, you would have one element there that would throw your revaluation entirely out of line with any one you might have on your books. Therefore, answering your question directly, if I were called upon to revalue that piece of property, or in other words, as I understand the term "revaluation," as used there it would be the cost of reproduction, I would take the units, the physical units, that were necessary to build that road and apply to them the cost of those units at this time, regardless of the original cost, or regardless of how many times it might have been reconstructed, because the reproduction of the property would be a thing of to-day, without any reference whatever to the cost to the company of the property, which I stated a moment ago would be \$150,000.

Q. Now, eliminating all of those instances that you have referred to, and confining yourself to my statement, which is that the cost of the original line was \$50,000 a mile, the cost of the second line was \$50,000 a mile, and the cost of the third line was \$50,000 a mile, and that the cost of reproduction represented in the material or labor has not changed. What is the reproduction value of that road? A. If the cost of the labor and material has not changed, is an average for those three, or for any one of them?

Q. As applied to all of them. — A. As applied to all of them?

Q. Yes, sir. — A. In other words, taking the same condition, if the original road could be rebuilt for \$50,000, I certainly give that as the reproduction cost of that road.

Q. Then, your position is that the present value of the existing property is \$50,000 a mile, but for the purposes of capitalization and rate making, it is \$150,000 a mile? — A. Absolutely, no; and I do not think that my testimony can be so construed.

Q. It would be put into the property account at \$150,000, would it not, according to your testimony? — A. The answer to that question — and when I get over the bounds I suppose I will be checked — is simply this: Whether I am right or whether I am wrong, or whether it conforms with the Interstate Commerce Commission's rules or not, as an accountant, I believe that the accounts of the company should be made to reflect the actual conditions as they occurred and under no circumstances should the reflection of the conditions through the accounts be distorted to fit an accounting theory. The principle, as I endeavored to give a moment ago, is that there has been \$150,000 spent for the purpose of a line between given points. It has absolutely no relation in any sense, in my humble judgment, to operating expenses, and whether that \$150,000 is capitalized is an entirely different proposition, and one that not only should not, but, so far as the companies I have been connected with, never has, regulated the capitalization of the property. The money is spent, and if it can be capitalized, and the people who furnish the capital are willing to capitalize it, why that is one proposition. If it is not capitalized it may just as well stand on the books, where everybody can see it, as so much money having been spent for that purpose. If, in the judgment of the owners of the property, it should be written off to profit and loss, very well and good; but that is not within the function of the accounting department. That is a business principle that must be governed by the directors of the company.

Q. Where would your three items for the three different lines finally land in your accounts? — A. Why, if I guessed right a moment ago at your illustration, I have seen the balance sheet of that company, and it stands out as plain as the nose on a man's face, the reconstruction of the line between certain points as distinguished from the original cost of the property.

Q. I am not speaking as to the practice in that case, because I do not know anything about it, but I am trying to get at your view, as an expert accountant, where the money that has been thus expended for the building of three separate pieces of road. — A. Yes, sir.

Q. At a uniform cost of \$500,000 each time, where does that \$500,000 finally land in your system, or your ideal system, of accounting? — A. Did you say "ideal" or "my idea"?

Q. Your ideal system of accounting; you are an expert. — A. I do not claim that, and I would rather not be classed as an expert, because I have a little aversion to those sort of people, as a rule; but as a practical accountant —

Q. Put it that way, if you will. — A. Yes; I would prefer that way, if you have no objection to it.

Q. That is entirely satisfactory. — A. Coupled with what I am egotistical enough to believe my business ability, if I was keeping

those accounts or had supervision or control over the man who was keeping them, those items would appear on the face of the balance sheet for just exactly what they represent. In other words, there is a common principle among accounting officers in opening ledger accounts that the title of the account should indicate as nearly as possible what is included in the account; and if I was controlling that situation I would have as many accounts as are necessary to reflect the facts. Now, whether you want to group those accounts for the purpose of annual report or other report and the cost of the road and franchises, or some other prescribed form, that would be quite immaterial to me so long as the balance sheet of the company stated the facts.

Q. Now, assuming that you were required by law to state the cost of the existing road, or to so classify and keep the accounts that the balance of some one account would show the cost of the existing road at any given time, would you keep all three of those investments in that account? A. I will have to make just a little explanation on your word "keep." I would keep the accounts of the company and produce the balance sheet of the company in the manner that I have explained. If by any law or rule or regulation, which we are always ready to observe, I were required to condense those accounts in any way in order to make a report to a commission, which I assume was a fair illustration of your point, I would put those three items of \$50,000 together, and I would report one item of \$150,000 under their approximate head of cost of road and franchises, and I would very carefully go over on the other side of the page and explain what was included in that report.

Q. Getting away from the requirement of the commission, suppose you were required by law to state in one account the balance which should, at any given time, show the cost of the existing property, and taking my illustration now, when the first road was built, you would charge the \$500,000 into that account, would you? A. Yes, sir.

Q. When the second terrace was built and the \$500,000 was expended, would you charge that \$500,000 into that account? A. I would. Excuse me, when I say "charge," I mean I would include it in the account you speak of.

Q. Well, I ask you if you would charge it to the account as showing the cost? A. I am not trying to evade your question at all.

Q. I think not. I am after light. A. But the point I wanted to make is that I am proceeding on the assumption that there is no law that prevents a corporation from keeping its business in as much detail as it may desire for its own purposes. I do not think we will ever get to that point, and I certainly hope not; but assuming to answer your question that I keep three different accounts of these three reconstruction jobs, and there was a law which required me at some time to report under some one head, which I understand is your point, the cost of the property, I would unquestionably include those three items of \$500,000 each and swear to that as the cost of the road. Is that the point?

Q. No; I think you have become enamored with your theory and have gotten away from my illustration. I said, assuming that the law required you to keep one account you may keep as many others

as you like—but to keep one account, the balance in that account to show, at any given time, the actual cost of the existing property. Now, when the first road was built, you would charge into that account \$500,000?—A. I would.

Q. When the second terrace is built, and you are called upon to dispose of that \$500,000, would you charge that into that account?—A. I would.

Q. When the third terrace is built, and you are called upon to dispose of the third \$500,000, would you charge it into that account?—A. I certainly would.

Q. Would you take anything out at the time you made the second charge?—A. I would take out only such credit as might be due from the salvage that might be recovered; but I would make no allowance for the original cost of the old sections of line that were destroyed.

Q. What would you take out of that account when you made the second charge of \$500,000?—State that specifically as you can.—A. Nothing in the world but credit for whatever salvage I might have recovered from the old line. To illustrate your point—

Q. Suppose it was ten thousand dollars a mile?—A. You mean for salvage?

Q. Yes.—A. I would credit that to the account.

Q. That would leave the account standing, then, charged with a cost of \$90,000 a mile?—A. Yes; on the two propositions.

Q. On the two propositions?—A. That is right.

Q. When the second terrace was built, and you had to deal with the third \$500,000 and charged that in, would you take anything out there?—A. If I had been fortunate enough to have any salvage, I would take that out.

Q. Suppose it was \$10,000 a mile?—A. I would take that out.

Q. You would deduct that?—A. Yes; making the cost of the property

Q. That is all you would charge?—A. Yes, sir; leaving the cost of the property \$130,000 in round figures.

Q. Showing the cost of the property to be \$130,000 of the existing property?—A. In this report which I am required to make by law?

Q. Yes.—A. Yes, sir.

Q. Now, I understood you to say also that if you were called upon to make the reproduction value of that line as now existing, and there had been no change in the cost of materials and labor, that would be \$50,000 a mile?—A. Yes; if I were to make an estimate to reproduce that road under present conditions and there had been no material difference in labor and materials, I would say that that piece of road could be reproduced for \$50,000 a mile.

Q. Your statement under the law as to the cost of the existing line would be \$130,000?—A. That is correct.

Q. And your report of the cost of reproduction would be \$50,000?—A. Both of which are strictly in accordance with the facts, from my point of view as an accountant.

Mr. NEEDHAM. That is all.

Redirect examination by Mr. WICKWIRE:

Q. Referring to the illustration pointed out by counsel of a railroad constructed at a certain point, which is washed out and then constructed at another point, and then washed out again, and then

built at a third location, it is assumed, is it not, that the original location was based upon the opinion of the engineers, upon the best information then obtainable as to a proper location of the road?—

A. Certainly; that presumption always prevails, that the promoters are doing the best they can in the initial move.

Q. Yes. Now, suppose there has been a washout due to the fact that the water has reached a stage in a freshet which is unprecedented. There is no occasion there for treating the case as an error of judgment?—A. None whatever. As I say, all roads, so far as my experience has gone, have been built with the best lights that they have before them at that time, and these other conditions are developed either by experience or by change in conditions. Talking about freshets and streams, they change their beds. The original location was perfectly good before the river changed its bed.

Q. Yes; and it is also to be assumed, is it not, that had the engineers possessed the information which they later obtained as to the height that might be reached by that water through an extraordinary freshet, it would have justified a different location at the beginning?—A. That is my understanding. I think I stated a moment ago, if I may be permitted to refer to it again, that those conditions have been discovered during the construction of the line, and changes made before the line was ever completed or opened for operations.

Q. Yes. Now, will you state how that matter is treated under the commission's present regulations?—A. Unless I misread the classification, there is not any question in the world but that every dollar that has been spent in creating a piece of property before it is opened up for operations, whether you make twenty different surveys in order to locate a line, which is your initial move, and which is not an inexpensive proposition, and changed your line during the course of construction three times, as has been graphically illustrated by counsel, there is not any question but what, under their classification, every dollar is charged to cost of road and franchises, because there is nothing else to charge it to. There is no profit and loss, because the company is not operating; it is merely a construction company.

Q. Do you know of any sound reason for treating these expenses of producing a road differently, depending upon whether the washout occurred during the process of construction or immediately after?—

A. I do not. It seems to me a sound business principle all the way through.

Q. To treat it as capital expenditure?—A. Yes, sir.

Q. Now, in your general ledger, under your system of keeping accounts, you would keep track and enter in detail, would you not, the various items representing capital expenditures of this kind?—A. Yes; and would furthermore reflect them in the public annual reports.

Q. And in making up a general balance sheet, you consolidate two or more items, do you not?

Mr. NEEDHAM. I did not hear that question. Will you read it?

The REPORTER (reading):

And in making up a general balance sheet, you consolidate two or more items, do you not?

Mr. NEEDHAM. What are you talking about; I do not understand.

Mr. WICKWIRE. Two or more accounts.



MR. NEEDHAM. Do you mean by that the number of accounts gradually decrease as they go into a balance sheet.

MR. WICKWIRE. Yes.

MR. NEEDHAM. It is not necessary to prove that; we all know that fact. That is the object of a balance sheet.

By Mr. Wickwire:

Q. You have, under the regulations of the commission, certain prescribed forms and certain prescribed items which are to go into the balance sheet?—A. Yes.

Q. And you may keep them in greater detail in your own general ledger?—A. Yes.

Q. And then when you make up the trial balance sheet, conforming to the findings of the commission, it is necessary for you, in certain instances, to consolidate two or more of your accounts in your general ledger?—A. That is right.

Q. And you make what are called your subprimary accounts?—A. Call them anything you want. They represent capital expenditures, and are so consolidated in the reports to the commission, just the same as you keep the five hundred operating expense accounts and report only five to the commission.

MR. WICKWIRE. That is all.

MR. NEEDHAM. I have no further questions.

MR. WICKWIRE. Call Mr. Phillips.

C. G. PHILLIPS was called as a witness on behalf of the petitioner, and, being first duly sworn, testified as follows:

Direct examination by Mr. Wickwire:

Q. Will you state your name?—A. C. G. Phillips.

Q. And residence?—A. Chicago.

Q. And occupation?—A. Secretary, Association of American Railway Accounting Officers.

Q. How long have you occupied this position?—A. Since 1888.

Q. As such, you are the custodian of the records of the association?—A. Yes.

Q. I wish to show you some documents, which purport to be copies of the records of the association and of the committee on corporate, fiscal, and general accounts, and will ask you to state whether or not these are correct copies of the records of the association in respect of the action of the association and this committee.—A. They are.

Q. Were the resolutions set forth in these papers and transactions therein recited adopted and had by this association and this committee?—A. Yes.

MR. WICKWIRE. I offer these in evidence.

MR. NEEDHAM. Just a moment, if your honors please.

MR. WICKWIRE. I offer also, in connection with these copies, the twenty-fifth annual report of the association and the twenty-fourth annual report of the association. These are referred to in the copies which I have already offered, and I suggest that these be received, only such portions thereof as either side may wish to be copied into the record.

MR. NEEDHAM. I was going to make the suggestion, if I may, with reference to the introduction of these records, to introduce the whole printed document into the record would make the record very cum-

bersome. I do not see why we should not agree that these records and any others that we may want to call your attention to may be considered and used in argument and by the court to any extent counsel on either side desire to use them and not have them so incorporated into the record that when the record of the case is made up and printed all of this volume would have to be printed in full, because in these books, of course, there is considerable that does not refer to the matter in controversy.

Mr. WICKWIRE. Will not my suggestion cover it that these are received with the understanding that only such portions thereof as counsel for one side or the other may desire need be copied into the record?

Mr. NEEDHAM. I simply want to save the record.

Judge CARLAND. Yes; that is proper, to keep the record down as small as you can.

Mr. NEEDHAM. Now, I notice in this first offer that there is an Exhibit A, which I have not had time to examine, but attached to it, apparently, from this certificate, it gives the records and the official minutes of a meeting held at Colorado Springs June 29 and 30 and July 1, 1910. These proceedings, of course, occurred after the adoption and promulgation of this order, which was in 1909, or of this classification, and this balance sheet, although I have not read it, I can not quite see what bearing that would have upon the classification which was made in 1909.

Mr. WICKWIRE. Well, if your honors please, counsel has interrogated the witnesses in regard to the action of this association, and it is a matter that I did not raise or bring out in any way, and in order to show just what the association has done and what its position has been in the matter, it seems to me the copy of all of these proceedings down to date should go in.

Mr. NEEDHAM. I do not object to the introduction of any resolutions or records, properly identified, taken prior to the classification, but anything that they may have done since the classification, it seems to me, does not have, and could not have, of course, any bearing whatever upon the reasonableness of the action taken by the commission prior to such action.

Judge CARLAND. As I understand counsel, they are only offering it in connection with some testimony that was drawn out by your examination. Now, they ought to find whatever there is in there that bears upon that subject.

Mr. WICKWIRE. Mr. Denison introduced yesterday a part of the Buffalo meeting held—

Mr. DENISON. Bulletin No. 28, Exhibit C, which was in June, 1907.

Mr. NEEDHAM. That is the only reference that has been made in the introduction of that yesterday, in the cross-examination of Mr. Plant. That is the only reference that has been made to this association. That was action taken back in 1907, before the classification was promulgated by the commission. The classification was promulgated in 1909.

The COURT. The court is not familiar, of course, with all of these documents and do not know what they show. What are they offered for—for what purpose?

Mr. WICKWIRE. Well, counsel for the other side has introduced this evidence and brought it out. I personally did not regard it as

material, but I did not take objection to it, because I thought if counsel wanted to put it in and the court wanted to consider it, I was willing to let it go in for what it was worth; but if any part of the proceedings of this association are to go into the record, it seems to me clear that the full record should go in, so as to show what the position has been and not to show a partial and fragmentary view of the association's position. Of course, counsel calls attention to the fact that the first issue of the expenditures for additions and betterments went into effect in 1909, but there was a revised issue of the same classification, which was later promulgated and became effective July 1, 1910, showing that the first classification was not a finality and that the commission was making changes and evolving their system, and if counsel wants to add any of this in the record, it seems to me that the court should have the whole history of exactly what the position of the association has been.

Judge CARLAND. You will be entitled to introduce all the transactions that have reference to the point at issue.

Mr. WICKWIRE. Yes.

Judge CARLAND. But to offer the book here, that is different.

Mr. WICKWIRE. These resolutions which I have offered relate only to the treatment of abandoned property, and are entirely germane so far as they may have any competency to the questions involved in this case, and this book is offered only because it was the form in which these copies are gotten up, in such a fashion as to refer to Exhibit A, hereto annexed. They are taken from Exhibit A, Mr. Phillips, I believe?

The WITNESS. Yes, sir.

Mr. WICKWIRE. And refer to it. It is the form in which he has made these copies, but let me inquire: Is there anything in Exhibit A that is necessary to go in here? Have you not copied everything that is in here?

The WITNESS. I think it is all in the copy.

Mr. WICKWIRE. Mr. Phillips states he thinks everything in here is in these copies, and the reference to this is unnecessary and superfluous for our purpose. He said those copies are taken from Exhibits A and C, but I suggest we might change the form of these copies to refer to the reports of the association for those two years, without stating that they are annexed.

Mr. NEEDHAM. These do not purport to be all the proceedings of the association at the meeting referred to, as I understand it.

Mr. WICKWIRE. No.

Mr. NEEDHAM. You have segregated out from the minutes such items as you desire to present?

Mr. WICKWIRE. Well, I think they are complete, so far as they relate to the treatment of abandoned property.

The WITNESS. I think so.

Mr. NEEDHAM. It also includes some other matter, I notice here, as construction accounts and discounts, etc. They seem to be included in there. I have not had a chance to read them carefully. This first resolution seems to be the one that refers to the matter in controversy.

The WITNESS. Exhibit A, which is the full minutes of a meeting, this part of it, relates to additions and betterments; only that part of it.

Mr. NEEDHAM. The rest of it relates to other things?

The WITNESS. To other things; yes, sir.

Mr. NEEDHAM. Now, I see no reason why the record should be encumbered with this other matter, which has no reference to anything whatever in controversy in this suit. Here is the resolution with reference to the matter in controversy. The rest of it refers to construction accounts and discounts, etc. We are simply encumbering the record to put in any more than the resolutions which were adopted by this association or by this committee with reference to the treatment of abandoned property. That is all we need to show the attitude of this association. Now, I have no objection to those resolutions being introduced, except that a resolution adopted after the classification was made, and after this improvement was entered upon, would hardly have a bearing. At the same time, I should be willing to let it go in under objection. I do not care to argue the thing now. I am perfectly willing that all the resolutions relating to that go in.

The COURT. The whole purpose is simply to show how the association viewed this matter.

Mr. NEEDHAM. That is it; as bearing upon the question of the reasonableness or the arbitrariness, if I may use that word, of the commission in adopting this particular classification.

The COURT. It would seem that their view of it would be just as relevant after the action of the commission as before, as long as the question now to be decided is what is the proper way to treat the improvements. If it is just their view, that is material. Their view at any time would be relevant.

Mr. NEEDHAM. That would be true if the court is going to pass upon its own judgment, on the wisdom of adopting a theory which the commission adopted as against this other; but if the issue in this case is determined by the conditions at the time the commission adopted the theory, in order to determine whether, by the adopting of it at that time, under the conditions then existing, it acted arbitrarily, it is like trying the case of the reasonableness of rates upon a record made; you can not make a new record.

The COURT. I can not, of course, determine now what the court that hears the case will think of it and how they will view it as to the power, and so forth. I think perhaps I had better let it in the evidence; that is, all that relates to this matter. We do not want anything else, of course.

Mr. WICKWIRE. I would be glad to confine it to the resolution.

Mr. DENISON. I have looked through this, and I can not find anything that bears upon the particular matter here at all, excepting a reference to a report reciting the steps taken in connection with the adoption of the classification of additions and betterments and the form of balance-sheet statement; and the statement says that it is supposed that the report will doubtless be printed, but it does not appear to be incorporated here.

The COURT. I think you had better eliminate in this certified copy anything that does not refer to the question of abandoned properties and let the balance be admitted.

Mr. WICKWIRE. I will be very glad to adopt the court's suggestion and during this evening I will go over these copies and revise them.

so as to eliminate any matter that does not relate to these questions here involved, and then we will present them in the morning.

Judge CARLAND. We will take an adjournment now until ten thirty o'clock to-morrow morning.

Whereupon, at 4.30 o'clock p. m., the hearing adjourned until to-morrow, Thursday, December 12, 1912, at 10.30 o'clock a. m.

WASHINGTON, D. C.,

*Thursday, December 12, 1912 10.30 o'clock a. m.*

Present: Mr. Justice Carland.

Appearances: Mr. Arthur M. Wickwire, for the petitioner. Mr. Winfred T. Denison, Assistant Attorney General, and Mr. Thurlow M. Gordon, special assistant to the Attorney General, for the United States of America, respondent. Mr. Charles W. Needham, for the Interstate Commerce Commission, intervening respondent.

#### PROCEEDINGS.

Mr. Wickwire. May it please the court, I will ask Mr. Phillips to resume the stand.

C. G. PHILLIPS, the witness under examination at the time of adjournment on yesterday, resumed the stand, and testified further, as follows:

By Mr. Wickwire:

Q. Have you now prepared a statement showing the action of the Association of American Railway Accountants and of its committee on corporate, general, and fiscal accounts, in respect to the matter of the classification of additions and betterments? -A. I have.

Q. Have you that statement now with you? -A. I have.

Q. Is that complete, according to your understanding? -A. It is complete, taken with Bulletin 28.

Q. Which has already been introduced? -A. I understand so.

Mr. Wickwire. I offer this in evidence.

Mr. DENISON. I have no objection.

Mr. NEEDHAM. I reserve an objection to the introduction of the same taken subsequent to the classification adopted by the commission in 1909.

Judge CARLAND. The objection is overruled.

Mr. Wickwire. That may be marked "Petitioner's Exhibit No. 11."

The papers referred to were received in evidence, marked "Petitioner's Exhibit No. 11," and are filed herewith.

#### PETITIONER'S EXHIBIT No. 11.

At a meeting held at Buffalo, N. Y., June 13, 14, 1907:

The committee proceeded to the consideration of the tentative classification of additions and betterments.

Mr. Riebenack on behalf of the Pennsylvania Railroad and Company handed in the following memorandum:

#### " MEMORANDUM.

Mr. Riebenack stated in regard to the subject of the preparation of a text for additions and betterments that he had been requested to make the announce-

ment that this subject had been taken up with the Interstate Commerce Commission by the president of his company and as stated both to the Interstate Commerce Commission and the Association of American Railway Accountants the instructions are that the accounting officers have nothing whatever to do with this subject, as it is a matter for the executive officers of the company and that this is the stand taken by the Pennsylvania Railroad Company. I have been requested to put myself upon record to continue this position both for the lines east and west of Pittsburgh, and to state that they cannot participate in the preparation of any text for the classification of additions and betterments."

Mr. H. D. Bulkeley was recorded as not voting on questions relating to additions and betterments classification.

The following preamble and resolution was adopted:

"Whereas, it is recognized by the standing committee on corporate, fiscal, and general accounts of the Association of American Railway Accountants that the matter of classification of additions and betterments expenditures, studies matters of financial policies of carriers, and while the committee has formulated such classification and text therefor, it is felt that the whole subject should be submitted to the executive officers of lines members of the association; Therefore

"Resolved, It is the sense of this standing committee that before this bulletin is submitted to the Interstate Commerce Commission that such members of the association as desire to submit the same to their executive officers for suggestions be permitted to do so, and have their answers to the chairman of this committee, Mr. A. H. Plant, comptroller, Southern Railway, Washington, D. C., before the 1st of July 1907, and that the letters submitted to the chairman of this committee be transmitted to the Interstate Commerce Commission with the classification and text."

The tentative classification of additions and betterments expenditures and text therefore was adopted in the form shown in bulletin No. 25.

At a meeting held at New York, October 15 and 16, 1907.

Additions and betterments. The chairman reported "that this matter is under consideration and report will be made thereon to this committee at February, 1908, meeting."

At a meeting held at Washington, D. C., Feb. 3, 4, 5, 6, 7, and 8, 1908.

On the subject of additions and betterments the following resolution was adopted:

"Resolved, That further discussion on additions and betterments be postponed until the consideration of the balance sheet."

At a meeting held at Washington, D. C., April 27 and 28, 1908.

"(1) Resolved, It is the sense of this standing committee that the matters, the adoption of (1) a balance sheet and text therefor and (2) a classification of additions and betterments and text therefor, are of such vital importance that they require further careful consideration and should therefore be deferred until after July 1st next, in order that they may be given further thought and study; and

"(2) Resolved, That the chairman convey the sense of the foregoing resolution to Mr. H. C. Adams."

At a meeting held at Atlantic City, N. J., July 6th, 7th, 8th, and 9th, 1908.

Resolved, That the findings of the committee on corporate, fiscal, and general accounts in connection with the uniform balance sheet, additions and betterments, and like questions be bulletined and submitted to the chief accounting officers, members of the Association of American Railway Accountants, for submission to their chief executive officers for such action as they may desire to take."

At a meeting held at Hotel Waldorf Astoria, New York City, Nov. 16 and 18, 1908.

"Whereas it has been the custom of American railroads heretofore in construction of new lines and other considerable improvements resulting in the temporary or permanent abandonment of property not to make any credit to their general property accounts for the reasons:

"1st, That the money actually spent in the acquisition or construction of such property constituted an outlay on which the owners were entitled to return; and

"2nd. Because the construction of new lines or improvements indicated growth in business and consequent enhancement and appreciation of the property as a whole far in excess of the apparent loss occasioned by the abandonment of the old lines or other property; and

"3rd. Because where the abandoned property was not sold and the proceeds credited to the general property account, there was always the possibility of its being used again or increasing in value as real estate; and

"4th. Because when new capital was raised for the construction of the new lines or improvements, the parties furnishing such capital were entitled to have it appear on the books of the carriers that it had been expended for the purpose for which it was raised. Therefore be it

*Resolved*, That the estimated value of abandoned property be not segregated from the general property and amortized as proposed in the balance sheet submitted by the commission."

At a meeting held at Chicago, Ill., Jan. 17th, 18th, and 19th, 1910:

*Resolved*, It is the sense of this committee that all expenditures incidental to additions and betterments should be charged to the job. That in the case of replacements involving a betterment, the cost of renewing in kind, including expenditures incidental thereto, should be charged to operating expenses and credited to the job.

*Resolved*, It is the sense of this committee that the classification of additions and betterments expenditures should be revised so as to permit of charging all expenditures on a particular job to that job, especially as the accounts are to be redistributed to conform to the classification of expenditures for land and equipment."

At a meeting held at Buffalo, N. Y., April 6th and 7th, 1910:

"Whereas the committee, having under consideration the classification of expenditures for additions and betterments as promulgated by the Interstate Commerce Commission, recognizes that certain requirements in that classification cannot be determined with accuracy, and that the rules therein expressed relative to addition and betterment work, undertaken or contemplated, may give to be the occasion of great embarrassment to managements;

*Resolved*, That the following recommendations be submitted to the commission through its representative as conveying the opinion of the committee:

"1. It is recommended that carriers be permitted to use their discretion in the application of the rule as explained in paragraph 4 of the general instructions of the classification of expenditures for additions and betterments in regard to the \$200,000 minimum fixed on expenditures for additions and betterments.

"2. In respect to paragraph 5 of general instructions: that paragraph provides, among other things, 'the cost of replacing the abandoned property in kind, plus the cost of removal, less the value of salvage, should be charged to appropriate accounts under operating expenses.' There is no provision in the classification of operating expenses for the charges of abandoned property, appropriate accounts under operating expenses.' There is no provision in the introductory letter on page 10, that 'it should be remembered that the charges included in operating expenses are designed to cover the current cost of maintaining and operating the property.' It appears to this committee that with this definite understanding as to the purpose and intent of the classification of operating expenses, to charge into and to make a part of such expense either at one time or at various times the cost to replace in kind so-called abandoned property would do violence to the classification of operating expenses and would destroy the purposes for which that classification was prepared. Furthermore, to apply the rule in respect to abandoned property as suggested by the commission would, in many cases, duplicate charges made through operating expenses or income and would not in the final analysis show the true cost of the property. To illustrate: it is the purpose of a carrier to place its grades and alignment on a line, say twenty miles long, the original use of which standing in the property account is \$10,000 per mile. A single track revised line can be built for \$25,000 per mile. The original track standing in the property account at \$10,000 per mile has from time to time to meet the demands of traffic been rehabilitated through operating expenses and brought up to a cost to replace of \$20,000 per mile. Operating expenses have made a charge to the extent of \$10,000 per mile. That track is abandoned, and upon its abandonment it becomes necessary under the rule to charge operating expenses with the cost to replace in kind or \$20,000 per mile. The

difference between such cost of \$20,000 per mile and the cost to build a new line of \$25,000 per mile represents the amount which under the classification can be considered as a betterment to property. The result of adding expenses will be charged with an additional \$30,000 per mile the way to rebuild in kind the old line expenses, therefore stand a total charge of \$30,000 per mile for a \$25,000 per mile line. Property account must, under the rule, be credited with \$10,000 per mile on account of the abandoned property, and on the other hand charged with \$5,000 per mile for the line built, leaving in property account a net of \$15,000 per mile as representing the cost of a line which actually cost to build \$25,000 per mile. From the facts it will be seen that not only does the rule do violence to operating expense accounts but understates the property account. The object sought to be gained by this classification of expenditures for additions and betterments is in substituting in respect to cost of property as fully recognized but this committee desires to point out the fact that the object thus sought can not be so through the rule prescribed for the treatment of property abandoned. Another is drawn to the fact that a number of roads are now endeavoring to improve their properties in the way of changes of grades and sidings. Such lines are going to provide money for this work through the earnings of other lines finding the necessity for such improvements are usually less than other than through the assistance of subsidies. In the case above cited the road would have the privilege of its way only \$5,000 per mile of additional charges to construct a line costing it \$25,000 per mile. It could not expect to have to provide the additional \$20,000 per mile out of its income. A very application of the rule would, in the judgment of the committee, under present conditions prevent many lines from improving their properties because of the fact that they would be unable through these restrictions to make funds to improve their income accounts and in this way to take care of the difference between the cost to produce and the amount they could charge their property accounts. It should be borne in mind that the restriction for these improvements is the reduction of operating costs and in fact the rule is aimed to avoid the constantly increasing demands of traffic. It is the committee's recommendation that the commission be requested to so modify this respect to charges in operating expenses for abandoned property as to provide that where in existence as of July 1, 1907, in connection with a given section of improvement, as to permit a carrier to so dispose of the cost of a property abandoned as will most equitably meet their individual special and unusual conditions, i. e., by charges in operating expenses, or additions and betterments.

3. It is not infrequently happens that abandoned improvements are made with improved or different facilities are so considerable in amount as to make the charge to operating expenses in the accounts for a single year so therefore felt that permission should be given carriers to create reserve through their maintenance of way accounts a reserve for the purpose of allowing a specific portion of the property by replacing it with property of different or improved type. It is recognized that in the introduction as of June 15, 1900, permission is given to create reserve accounts in accounts of way and structures through operating expenses for the purpose of so disposing of a specific piece of property.

4. In connection with account 2—widening cuts and fills, it is seen that the difficulty, and in fact we might say the impossibility of so determining the measure of additions and betterments by widening cuts and fills in many cases, particularly on old roads, is recognized. It is felt that some allowance should be given to carriers in determining by what extent cost is incurred to expenses or should be charged to additions and betterments.

5. The same difficulty arises in connection with the proposition of classifying in account 3, except that it is felt that the increased cost of substitution of masonry, steel or concrete construction for softwood should be charged to additions and betterments.

6. As to account 8—increased weight of rail, it is felt by the committee that to consider as an addition and betterment the increased weight of rail on the track in renewals does not enable a carrier to provide the maintenance measure for its rail through its operating expenses. The committee feels that such carriers as so exact should be permitted to provide for maintenance by charging the entire cost of the new rail, less savings in operating expenses. The difficulties suggested by the committee may be avoided when we consider the ruling of the commission in respect to renewal of rail.



work with secondhand rail, that is to say, under the rule and under subsequent rulings, all increased weight of rail, whether firsthand new rail or secondhand rail, must be considered an element of additions and betterments, thus absolutely wiping out the proper maintenance of rail in track through operating agencies. In the case of a newly constructed line where light rail was originally or purposely used when such rail is removed with a heavy pattern it is felt in such cases that there is a distinct element of betterment.

7. The objections raised to account 8 and the suggestions made by the committee with respect thereto apply with greater force to accounts 9, improved frogs and switches, and 10, track fastenings and other material. The committee desires to further bring out the fact that the element of additions and betterments in these classes of material is inconsiderable and in many cases negligible of a correct analysis; therefore the committee suggests that the recommendations embodied in section 6 be applied to accounts 9, improved frogs and switches, and 10, track fastenings and other material.

8. In respect to account 21, equipment, regarding the difficulty of arriving at a reasonably correct measure of depreciation the committee is of opinion that in lieu of carrying depreciation, carriers should be given the privilege of providing for replacement of equipment retired by operating expenses through the medium of charging to operating expenses the cost to replace equipment in and at the time such equipment is retired from the service. The reserve thus created should be available for the purchase of new equipment required.

The foregoing resolutions adopted at Buffalo, N. Y., April 6 and 7, 1910, were reported to the Association of American Railway Accounting Officers held at Colorado Springs, Colorado, June 29th, 1910, and July 1st, 1910, and formally adopted by the association's resolution.

The following is a true copy of a resolution passed by the association of American Railway Accounting Officers at its annual meeting, held at Cincinnati, Ohio, April 29, 30, and 30, 1909.

Resolved: That the action of the standing committee on corporate fiscal and general accounts in preparing a form of balance sheet and text therefor, and a classification of additions and betterments, and submitting the same to all accounting officers, members of this association, for submission to their respective officers for such action as they might desire to take, be and be so duly approved, it being understood, however, that the approval thus given has no effect with it formal approval by this association of the balance sheet, classification of additions and betterments and texts therefor in detail, such as a balance sheet and classification and text being tentative in their character and subject to further contribution by the committee should the matters be again referred to it.

Mr Wickwire: That is all.

Mr Newman: That is all.

Mr Wickwire: Call Mr. Scott.

E. G. Scott was called as a witness on behalf of the petitioners, and being first duly sworn, testified as follows:

Direct examination by Mr. Wickwire:

Q. Please state your name? A. E. G. Scott.

Q. Where do you reside? A. Minneapolis, Minn.

Q. What is your business? A. Railway accountant.

Q. What is your present employment? A. Auditor of the Minneapolis & St. Louis Railroad Company.

Q. How long have you occupied that position? A. About five

years.

Q. Will you state what your prior experience has been? A. Prior to that time, for a period of 23 years, I held positions in the accounting department from chief clerk and auditor down to messenger.

Q. With what other railroads were you connected? A. With the St. Louis & Southwestern; prior to that, the Missouri Pacific, and prior to that the St. Louis, Iron Mountain & Southern, when it was a separately operated company.

Q. How long were you with the St. Louis Southwestern? A. About seventeen years—between sixteen and seventeen years.

Q. That was immediately prior to your going with the Minneapolis & St. Louis? A. Yes, sir.

Q. You are familiar with accounts? A. I think I am.

Q. Particularly railroad accounts? A. Yes, sir.

Q. Are you a member of the Association of American Railroad Accountants? A. Yes, sir.

Q. And of the committee of 25 on corporate general and fiscal accounts? A. I am.

Q. Are you familiar with the various regulations and classification of the Interstate Commerce Commission with respect to the matters involved in this case? A. Yes, sir; I think I am.

Q. Are you familiar in a general way with the issues involved in this case? A. I am.

Q. Will you please state whether, in your opinion, the estimated replacement costs of portions of property abandoned or discontinued in respect to the six sections of road involved in this case, when abandonment was made in connection with grade reductions, are properly chargeable against operating expenses? A. I am of the opinion that they are not proper charges to operating expenses.

Q. Will you state your opinion as to whether the expenditures for these grade reductions which were made all the line of the road are properly chargeable to capital account, without deduction for the parts of the line that were abandoned? A. I think they are, because under the change of operating conditions it was evidently found necessary, in order to not only operate safely, but economically, that the work should be done; and under those conditions I believe that the charge is a proper one to the property investment account.

Q. You understand, do you not, that the purpose of the grade reductions were to reduce expenses and to increase the efficiency of the road and the volume of traffic which it could handle? A. Yes, sir; and I should think in order to safely operate as well—to carry the passengers and freight over these particular pieces of line safely.

Q. Will you please state the reasons for your opinion in respect to these matters? A. As I have stated before, my reason is that, evidently, in the exercise of good judgment, it is found absolutely necessary to make these changes, and that changes of that kind would be proper addition to the property investment, rather than a charge to operating expenses.

Q. And will you state the reason why, in your opinion, the estimated replacement cost of the portions of the road discontinued is not chargeable to operating expenses? A. Because I believe it should be considered as part of the cost of the property.

Q. It is already in the capital account, as a part of that cost, so do I understand it is your opinion that it should stay there? A. Yes, sir.

Q. Do you regard that as an operating expense, according to the principles of accounting?—A. I do not; no, sir.

Q. You are familiar, are you not, with the fact that, under regulations of the commission, practically the entire expenditure in making the grade reductions at these parts of the line, if made on the original roadway, would have been chargeable to capital account? A. Under the regulations of the commission a part of it

cost would, of course, have been charged to capital account, and part to operating expense.

Q. The amount that is chargeable to operating expense, however, covers only a few minor items, does it not? A. Yes, sir.

Q. And substantially the entire amount is chargeable to capital account? A. Yes, sir.

Q. Do you know of any reason for a distinction in the method of making these charges where a grade reduction is made upon the original right of way or upon adjacent ground, if the sole purpose of the improvement is to effect a reduction of grade? A. I could see no reason why any distinction should be made.

Mr. WICKWIRE. You may cross examine.

Mr. DENISON. No cross examination.

Cross examination by Mr. NEEDHAM.

Q. Do you make any distinction in these respects, between the permanent property, the roadbed, and the equipment, the movable property, as to abandonment? A. Not if the same conditions apply; no, sir; I can not.

Q. In case the traffic demands a better class, a different class of cars, say, passenger cars, and to meet that demand new cars be put upon the line and the old cars are abandoned, what would you say with reference to the disposition then to be made in the property account of the abandoned cars or their value? A. If the abandoned cars were in repair and good condition, and were discarded because of the obsolescence, I can see no difference in the way the charges should be handled with respect to the value of those cars.

Q. You would retain it in the property account, would you? A. Yes; excepting whatever could be realized from the sale of them.

Q. That is to say, if there was a salvage, you would take the salvage out? A. Certainly.

Q. But would you allow the cost of those cars to remain in the property account, if having been a charge to the property account when the cars were bought? A. Left to my judgment, I would; yes.

Q. And what would apply to all discarded equipment for what you call "obsolescence" or "inadequacy," to meet the demands of the public? A. Yes, sir.

Q. And you apply the same rule to the roadbed? A. Yes.

Q. The result of that would be that the property account would include all purchases made and all expenditures made on account of roadway, bridges, and equipment, rolling stock, for all time, except the deduction of salvage, so far as changes were made necessary by obsolescence or inadequacy. A. It would remain in the property investment account.

Q. For all time? A. Yes, sir.

Mr. NEEDHAM. That is all.

Mr. WICKWIRE. That is all.

Mr. WICKWIRE. The petitioner rests, your honor.

Mr. DENISON. Call Mr. LAITZ.

## TESTIMONY ON BEHALF OF THE RESPONDENTS.

CHARLES A. LAITZ was called as a witness on behalf of the respondents, and, being first duly sworn, testified as follows:

Direct examination by Mr. DENISON:

Mr. Lutz, what is your position? — A. Chief examiner of accounts for the Interstate Commerce Commission.

Q. And you are by profession an accountant? — A. I am.

Q. How long have you been an accountant? — A. For about 20 years.

Q. How long have you been chief of the accounting division of the Interstate Commerce Commission? — A. Since June 16, 1908.

Q. Immediately prior to that, what was your employment? — A. As assistant comptroller of the Louisville & Nashville Railroad, for about seven years.

Q. Are you familiar with the investigations made by the Interstate Commerce Commission prior to the promulgation of the rules for uniform accounting? — A. I think I may say that I am, in a general way, before I came to the service of the Interstate Commerce Commission, and in a specific way since entering the service of the commission.

Q. Before issuing the definitions and rules and classifications objected to in this case, did the commission make an investigation into the different theories and practices current in regard to that subject? — A. Such an investigation was made under the direction of the commission; yes.

Q. Will you please tell us in your own words the history of the investigation? — A. The work of the formulation of a uniform system of accounts prescribed under the 20th section of the act to regulate commerce was begun soon after the adoption of the Hepburn amendment in 1906. The Association of American Railway Accounting Officers, of which I was then a member, at its 18th annual meeting, held at Hotel Champlain, Bluff Point, New York, in June, 1906, created a special committee on corporate, fiscal, and general accounts, with a membership of 25, consisting of chief accounting officers of lines members of the association, in the language of the association, "for the purpose of dealing with and directing matters incident to the corporate, fiscal, and general accounts of railways, including the consideration of accounts and returns required by the national and State commissions."

I will file a copy of the resolution of the association embodied in the circular letter, signed by the president thereof, to the members of the committee thus created.

Q. Have you that here? — A. It is here [indicating brief case]. It is locked up.

Q. Perhaps we had better take up the exhibits as we go along.

A. That is now locked, and the key will be here a little later.

Q. You have sent for the key? — A. Yes.

The Association of American Railway Accounting Officers includes in its membership accounting officers and heads of the various divisions of the accounting departments of companies operating practically the entire mileage of the steam railways of the country.

The Interstate Commerce Commission employed Mr. Henry C. Adams, formerly statistician of the commission, to devote his entire time for about two years to the consideration of the questions involved in the preparation of the proposed uniform system of accounts. A copy of a letter of Mr. Martin A. Knapp, chairman

the Interstate Commerce Commission, under date of July 27, 1906, announcing the designation of Mr. Adams for this work will be filed.

In the consideration, by the representative of the commission, of the matters involved in the preparation of a uniform system of accounts for steam railways, the cooperation of the committee on corporate, fiscal, and general accounts of the Association of American Railway Accounting Officers, which I shall hereafter refer to as the committee of 25, was availed of and conferences were early begun between Mr. Adams, representing the commission, and this committee. The first classification of accounts which was given consideration at these conferences was the classification of operating expenses. After extended conferences with a subcommittee appointed by the committee of twenty five, it was determined to issue a circular to all accounting officers of steam railways in the United States, and the railway accounting officers to whom it was addressed were asked to submit detailed suggestions relative to a revision of the official classification of operating expenses previously existing. A copy of this circular, which was issued by the division of statistics of the Interstate Commerce Commission, under date of September 16, 1906, as accounting series circular No. 1, will be filed.

I would suggest, if counsel does not object, that these exhibits be marked "Exhibits C, A, L., 1, 2, and 3," etc.

RESIDENT'S EXHIBIT C, A, L., NO. 1.

ASSOCIATION OF AMERICAN RAILWAY ACCOUNTING OFFICERS,  
OFFICE OF THE PRESIDENT,  
Washington, D. C., July 13, 1906.

(Personal.)

GENTLEMEN: The Association of American Railway Accounting Officers at its eighteenth annual meeting passed the following resolutions creating a special committee on corporate, fiscal, and general accounts:

"*It Resolved*, It is the sense of this association that the needs of the Association of American Railway Accounting Officers require a standing committee, with a membership of twenty five, consisting of chief accounting officers of lines members of the association, for the purpose of considering, dealing with, and directing matters incident to the corporate, fiscal, and general accounts of railways, including the consideration of accounts and returns required by the national and State commissions; the membership of such committee to be permanent unless disqualified by change of service or retirement.

"*It Resolved*, In order that the work to be allotted to such committee may be undertaken without the delay incidental to the necessary change in the constitution of the association, in order to provide for the creation of such standing committee, the association hereby appoints a special committee of twenty five consisting of the following named members, such committee to continue in office during the coming year and until discharged by the association: Mr. M. Buchanek, comptroller, Penn. R. R.; Mr. R. A. White, auditor, N. Y. C. & H. R. R.; Mr. M. P. Blauvelt, comptroller, Erie R. R.; Mr. C. N. Wilson, general auditor, Lehigh Val. R. R.; Mr. G. E. Hostis, general auditor, D. F. & W. R. R.; Mr. H. M. Kochersperger, 3rd vice president, N. Y., N. H. & H. R. R.; Mr. A. I. Culver, 2nd vice president, Delaware & Hudson Co.; Mr. W. J. Hobbs, 1st vice president & gen. auditor, Boston & Maine R. R.; Mr. I. G. Ouden, 3rd vice president, Can. Pacific Ry.; Mr. H. W. Walker, gen. auditor, Grand Trunk R. R.; Mr. A. H. Plant, comptroller, Southern Ry.; Mr. Chas. Haydon, comptroller, I. & N. R. R.; Mr. E. S. Benson, auditor, Panama Railway; Mr. M. M. Kirkman, vice president, C. & N. W. Ry.; Mr. W. N. D. White, gen. auditor, C. M. & St. P. Ry.; Mr. C. I. Sturgis, gen. auditor, C., B. & Q. Ry.; Mr. C. F. Krebs, comptroller, I. C. R. R.; Mr. Erastus Young, gen. auditor, Union Pacific R. R.; Mr. F. Noy, gen. auditor, C., R. I. & P. Ry.; Mr. Robt. Tombs, comptroller & gen. auditor, Wis. Central Ry.; Mr. R. I. Farring-

ton, and vice president, Great Northern Ry. Mr. H. S. Gray, comptroller, Northern Pac. Ry. Mr. W. H. Bailey, gen. auditor, A. P. & S. P. Ry. Mr. S. R. Schuyler, gen. auditor, Mo. Pac. Ry. Mr. R. C. Johnson, gen. auditor, St. L. & N. W. Ry.

"Whereas it is possible that some portion or persons, designated by resolution of the association as members of the special committee on corporate fiscal and general accounts, may, for good and sufficient reasons, be unable to serve, and whereas it is desirable that this special committee be composed of twenty-five members who are in a position to give active service, therefore be it

Resolved, That the president of this association be authorized to fill by appointment any vacancies in the special committee on corporate fiscal and general accounts.

"Further, the executive committee recommends to the association a change in the constitution of the association, creating a standing committee to consist of twenty-five duly accounting officers of those members of the association such committee to be designated as a standing committee on corporate fiscal and general accounts.

It is considered necessary at this time to arrange for:

(a) The convenient collection of membership by those connected with the committee, and the filling of vacancies which may be caused by the dropping of the members to serve.

(b) The initial meeting of the committee for organization purposes.

I therefore beg you will immediately upon receipt of this notice signify your acceptance or rejection of your nomination as a member of the committee.

I also suggest that Thursday, August 10, 1906, at eleven o'clock a. m. be selected as the time for the initial meeting.

Regarding the time which will necessarily be consumed by some of the members of course to and from the meeting, I deem it best to place in committee three chairs, viz., New York City, Chicago, Elkhart, Chicago, as places for the meetings, and to give the subject of one of these three places to the members of the committee, the meeting to be held at the place receiving the greatest number of votes. The expression of your choice is therefore requested in the enclosed card.

In view of existing conditions, I feel it quite important that this committee be organized at the earliest practicable date and that there should be no delay in the holding of the initial meeting.

A. H. PRATT, President.

BY ATTORNEY: SPECIAL COMMITTEE ON CORPORATE

FISCAL AND GENERAL ACCOUNTS.

RESPONDENTS: EXHIBIT F-A-1-80-2

INTERSTATE COMMERCE COMMISSION

Washington, July 27, 1906.

To:

The commission directs your special attention to the following provisions of requirements of the twentieth section of the act to regulate commerce as amended by act of Congress approved June 20, 1906, and which takes effect August 28, 1906, to wit:

"Sec. 20. That the commission is hereby authorized to require annual reports from all common carriers subject to the provisions of this act and from the owners of all railroads engaged in interstate commerce as defined in this act, to prescribe the manner in which such reports shall be made, and to require from such carriers specific answers to all questions upon which the commission may need information. Such annual reports shall show in detail the amount of capital stock issued, the amounts paid therefor, and the manner of payment for the same, the dividends paid, the surplus fund, if any, and the number of stockholders; the funded and floating debts and the interest paid thereon; the cost and value of the carrier's property, franchises, and equipments; the number of employees and the salaries paid each class; the accidents to passengers, employees, and other persons, and the causes thereof; the amounts expended for improvements each year, how expended, and the character of such improvements; the earnings and receipts from each branch of business and from all sources; the operating and other expenses; the balances of profit and loss; and a complete exhibit of the financial operations of the carrier each year, including an annual balance sheet. Such reports shall also contain such information as relation to rates or regulations concerning fares or freights, or any other matter

regulations or contracts affecting the same as the commission may require, and the commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this act, prescribe a period of time within which all common carriers subject to the provisions of this act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept.

"Said detailed reports shall contain all the required statistics for the period of twelve months ending on the thirtieth day of June in each year, and shall be made out under oath and filed with the commission, at its office in Washington, on or before the thirtieth day of September then next following, unless additional time be granted in any case by the commission, and if any carrier, person or corporation subject to the provisions of this act shall fail to make and file said annual reports within the time above specified, or within the time extended by the commission for making and filing the same, or shall fail to make specific answer to any question authorized by the provisions of this section within thirty days from the time it is lawfully required so to do, such parties shall forfeit to the United States the sum of one hundred dollars for each and every day it shall continue to be in default with respect thereto. The commission shall also have authority to require said carriers to file monthly reports of earnings and expenses or special reports within a specified period, and if any such carrier shall fail to file such reports within the time fixed by the commission it shall be subject to the forfeitures last above provided.

Said forfeitures shall be recovered in the manner provided for the recovery of forfeitures under the provisions of this act.

The oath required by this section may be taken before any person authorized to administer an oath by the laws of the State in which the same is taken.

The commission may, in its discretion, prescribe the forms of, and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this act, including the accounts, records, and memoranda of the movement of traffic, as well as the receipts and expenditures of money. The commission shall, at all times have access to all accounts, records, and memoranda kept by carriers subject to this act, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the commission, and it may employ special agents or examiners who shall have authority under the order of the commission to inspect and examine any and all accounts, records, and memoranda kept by such carriers. This provision shall apply to receivers of carriers and operating trustees.

"In case of failure or refusal on the part of any such carrier, receiver, or trustee to keep such accounts, records, and memoranda on the books and in the manner prescribed by the commission, or to submit such accounts, records, and memoranda as are kept to the inspection of the commission or any of its authorized agents or examiners, such carrier, receiver, or trustee shall forfeit to the United States the sum of five hundred dollars for each such offense and for each and every day of the continuance of such offense, such forfeitures to be recoverable in the same manner as other forfeitures provided for in this act.

Any person who shall willfully make any false entry in the accounts of any such accounts or in any record or memoranda kept by a carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify the record of any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the carrier's business, or shall keep any other accounts, records, or memoranda than those prescribed or approved by the commission, shall be deemed guilty of a misdemeanor and shall be subject, upon conviction in any court of the United States of competent jurisdiction, to a fine of not less than one thousand dollars nor more than five thousand dollars, or imprisonment for a term not less than one year nor more than three years, or both such fine and imprisonment.

"Any examiner who divulges any fact or information which may come to his knowledge during the course of such examination, except in so far as he may be directed by the commission or by a court or judge thereof, shall be subject, upon conviction in any court of the United States of competent jurisdiction, to a fine of not more than five thousand dollars or imprisonment for a term not exceeding two years, or both."

As to that portion of section 20 of the act which confers authority upon the commission to prescribe the forms of all accounts, records, and memoranda, and which forbids carriers from keeping any other accounts, records, or memo-

randa than those prescribed or approved by the commission, the carriers are advised that until the commission shall by order or otherwise prescribe the accounts, records, or memoranda to be kept by any or all carriers subject to the statute, no change in methods of accounting is required of any such carrier. On and after August 28, 1906, the authority of the commission to inspect the books and accounts of the carriers will, of course, apply.

The commission fully realizes the necessity of establishing as soon as possible a satisfactory system of accounting for carriers engaged in the transportation of commerce under the provisions of the regulating statute, and has determined to proceed immediately in the work of arranging and preparing for the discharge of its duty in the matter of prescribing such accounts, records, and memoranda and requiring all practicable uniformity in the accounting systems of the carriers.

Henry C. Adams, the present statistician of the commission, will, on and after August 1, 1906, have immediate charge of the preparatory work necessary to carry out the intention of the commission to prescribe the accounts, records, and memoranda of such carriers.

The attention of carriers is further called to the requirement in the amended section 20 that their annual reports must be filed with the commission on or before September 30 of this and each subsequent year, unless additional time be granted by the commission.

Very respectfully,

MARTIN A. KNAFF,  
*Chairman.*

#### RESPONDENT'S EXHIBIT C. A. L. No. 3.

Accounting series circular No. 1.

#### INTERSTATE COMMERCE COMMISSION.

#### DIVISION OF STATISTICS.

Washington, September 10, 1906.

DEAR SIR: The present official classification of operating expenses was adopted in 1894, the revision in 1902 being, in fact, little more than an incorporation into the body of the classification of such decisions upon minor questions as, from time to time, had been submitted by accounting officers.

The basis of this classification of 1894 was the "Saratoga classification," adopted in 1879, and in the letter promulgating its authorization by the Interstate Commerce Commission are found these words: "No change has been made in the general theory of classification adopted by the convention of State railroad commissioners held at Saratoga, June, 1879, the division of general accounts being the division authorized by that convention."

In view of the many changes that have taken place in recent years in the operation and administration of railway properties, it is not strange that the present official classification should fail to express what is best in current American practice; nor is it strange that the gradual extension of the supervisory functions of Government, both State and Federal, should require more extended classification and fuller reports based upon greater uniformity in accounting than at the present time.

As a first step toward the attainment of the aims thus suggested, it has been decided to ask railway accounting officers to submit detailed suggestion relative to a revision of the present classification. This decision was reached after an extended conference with the subcommittee of the committee of corporate, fiscal, and general accounts of the Association of American Railway Accounting Officers, and it was further decided that the attention of accounting officers should be called to the following points as worthy of especial attention:

1. It may be desired that an additional general account be made for the purpose of showing the cost of soliciting, gathering up, and distributing traffic. Suggestions are requested as to the subdivisions of such general account should one be adopted, the various items of expense that should be included in such subaccounts, and the name for the new general account.

2. It may be desired to have the classification so prepared as to show separately the cost of handling traffic in trains and the expense of handling traffic at points of origin and destination on each line. Suggestions are requested as to the grouping of subaccounts that will produce this result, and the various items of expense that should be included in such subaccounts.



3. In case monthly statements of earnings and expenses should be called for, what expenses, if any, should be prorated by months, and what expenses should be charged in the month when the obligation was created or the service rendered?

4. Suggestions are also desired as to the manner in which amounts paid for union depot facilities, or as proportion of expenses of operating joint terminal facilities should be treated in the accounts, whether they should be charged to one account, or whether they should be distributed among the different operating expense accounts that may be provided for by the proposed classification; also as to the proper account or accounts to which rental and expense of operating tracks belonging to other lines should be charged.

5. While refraining at the present time from expressing any opinion on the proposal that an authoritative rule should be formulated for the separation of operating expenses incident to the passenger service and the freight service, it is recognized that certain expenses can be accurately divided between the two services named. Your attention is called to this matter, with the request that you state in detail the extent to which and the manner in which such separation may be made.

6. The increasing use of electricity as motive power, and the increasing tendency on the part of steam roads to control electric lines, make the question of harmonizing the accounts of steam and electric railways an important one. This question is, at present, of relatively greater significance to the State commissioners than to the Interstate Commerce Commission, but this is no reason why the question of harmonizing the operating expenses of the two classes of railways should not be included in this circular. There has been in the past the most hearty cooperation between the State commissioners and the Interstate Commerce Commission so far as forms and methods of reporting are concerned, and it is intended in the revision of accounts now contemplated, to render that cooperation more direct and effective. To this end you are requested to give this subject careful consideration, and to submit suggestions for harmonizing the operating expense accounts of electric and steam roads, so far as may be practicable.

It is not intended that the responses of accounting officers should be confined to the points enumerated; on the contrary, any criticisms pointing out the limitations of the present official classification, or suggestions for its improvement, are invited.

It was understood in the conference herein referred to that the president of the Association of American Railway Accounting Officers should address a letter to the chief accounting officer of each line, member of the association, in relation to this matter, requesting that a duplicate of the replies made to this circular letter be forwarded to Mr. C. G. Phillips, secretary of the association, 143 Dearborn Street, Chicago, Ill., in order that the committee mentioned may have before it all necessary data for consideration before definite action is taken in the matter under review.

It is desired that replies to this letter be made to the undersigned not later than November 1, 1906.

Respectfully,

HENRY C. ADAMS,

*In Charge of Statistics and Accounts.*

Q. Why C. A. L.?—A. Simply to identify them as part of my testimony.

Q. Your initials?—A. Yes. Other classifications which were considered about the same time were the classification of "outside operations" and the classification of "operating revenues," to which more specific reference need not perhaps be made inasmuch as the provisions of these classifications do not appear to bear upon this case.

Early in the consideration of the proposed uniform system of accounts the importance of determining with particularity what classes of expenditures of a carrier should be included in operating expenses and what classes should be included in the cost of the property of the carrier became apparent. In order to secure all possible information to aid in the determination of this matter accounting series circular No. 5 was issued and sent to all the accounting officers

of all steam railway carriers by the Division of Statistics and Accounts of the Interstate Commerce Commission under date of January 15, 1907. A copy of this circular will be filed, marked "Exhibit C. A. L. No. 4."

RESPONDENT'S EXHIBIT C. A. L. No. 4.

Accounting series circular No. 5.

INTERSTATE COMMERCE COMMISSION.

DIVISION OF STATISTICS AND ACCOUNTS.

Washington, January 15, 1907.

DEAR SIR: It is assumed that operating expenses should be confined to expenses incident to the cost of maintaining the property and of performing the service of transportation, and that this cost should not be burdened with expenditures the purpose of which is to improve the property. In order to realize this assumption in the practice of the carriers the Interstate Commerce Commission desires to draw a clear line between depreciation, which is to be covered in operating expenses, and betterments and additions, which may be charged directly to income or to capital. It should be distinctly understood that the question here submitted is a question of accounting and not of financial policy. The propriety or impropriety of improving property out of current earnings is not now under discussion. This circular is confined to a consideration of the accounting problem involved, and assumes that this problem will be solved when the expenditures referred to are defined and classified and an appropriate place provided for their entry either in the income account or in the construction account.

You are requested, in replying to this circular, which, like the other circulars of this series, is issued after consultation with the accredited representatives of the Association of American Railway Accounting Officers, to observe the order indicated as follows:

1. This branch of accounting calls in question the use made, or which should be made, of the following terms:

Transportation cost.

Repairs.

Renewals.

Replacements.

Betterments.

Improvements.

Additions.

Construction.

(a) Which of the above-named terms are used in the records and accounts of your company? If other terms are used, name them. The purpose of this question is to obtain an exhaustive list of the terms employed by the carriers in their treatment of such expenses or expenditures as make their appearance along the border line between operating accounts and capital accounts, and to determine the nature of expenses or expenditures charged to those accounts.

(b) Define the terms employed by you in the accounts of your company, so as to make clear the manner in which they are used. The purpose of this inquiry is to learn what current practice is respecting this branch of accounting.

(c) State what terms, in your opinion, should be used in an authorized system of accounting, and what meaning should be attached to each. The purpose of this request is to secure from each accounting officer a comprehensive and analytic statement relative to this branch of accounting.

2. In general, it may be said that current practice allows for depreciation by including "renewals" or "replacements" in operating expenses, and, consequently, railways do not keep a formal depreciation account. It is at least open to question whether or not this is an appropriate method of procedure, and, as will be observed from the opening paragraph of this circular, its abandonment is suggested. For the purpose of collecting information necessary for a satisfactory conclusion upon this point the following inquiries are submitted:

(a) Do you keep a formal depreciation account of any kind or of any sort, or do you place exclusive reliance upon charging renewals and replacements to operating expenses in order to maintain the integrity of your property account? If a depreciation fund is kept, explain in detail the accounting procedure respecting it and the basis for computing the amount assigned to the fund.

(b) In case a formal depreciation fund is not kept, do you, in practice, make any use of the theory of depreciation in assigning sums from time to time for particular purposes? If so, explain your practice in this regard, especial care being taken to indicate the class of property for which renewal funds are kept, and the rules or methods followed in computing the amounts to be assigned to such special funds.

(c) You are also requested to consider this general question of depreciation accounts, and to state your reasons either for or against the continuance of the present practice of providing for depreciation. In case your views are, in general, favorable to the continuance of the present practice, while at the same time special applications of a depreciation account appears to you tenable, state in detail of the kinds of property which would be affected thereby.

The questions raised by this circular do not easily lend themselves to specific and detailed inquiry. The purpose of the circular, however, is clear. It is the desire of the commission, through the system of accounts which it shall prescribe, to guarantee the integrity of the operating expense accounts on the one hand, and of the property accounts on the other. Any suggestion bearing upon this point which you may care to submit will receive careful consideration.

It was understood in the conference herein referred to that the president of the Association of American Railway Accounting Officers should address a letter to the chief accounting officer of each line, member of the association, in relation to this matter, requesting that a duplicate of the replies made to this circular letter be forwarded to Mr. C. G. Phillips, secretary of the association, 142 Dearborn Street, Chicago, Ill., in order that the committee mentioned may have before it all necessary data for consideration before definite action is taken in the matter under review.

It is desired that replies to this letter be made to the undersigned not later than February 15, 1907.

Respectfully,

HENRY C. ADAMS,

*In Charge of Statistics and Accounts.*

In this circular the statement is made that it was assumed that operating expenses should be confined to expenses incident to the cost of maintaining the property and of performing the service of transportation, and that this cost should not be burdened with expenditures the purpose of which is to improve the property. The further statement was made in this circular that it was the desire of the commission to draw a clear line between depreciation, which was to be covered in operating expenses, and betterments and additions, which may be charged directly to income or to capital. The circular was confined to the consideration of the accounting problem involved and assumed that this problem would be solved when the expenditures referred to were defined and classified and an appropriate place provided for their entry, either in the income account or in the construction account. The words "income account" and "construction account" were there broadly used to designate respectively accounts representing the current revenues and items of income and the current operating and other expenses of the carrier corporation on the one hand as distinguished from the expenditures on account of the property investment of the carrier on the other.

MR. WICKWIRE. Just a moment. If your honor please, the witness appears to be reading a statement that gives the construction of certain documents issued by the commission in the years 1906 and 1907, and at that time he was not connected with the commission's work. He was not connected with the commission until 1908. It seems to me that it might be better to have these documents introduced in evidence and to allow the court to place its own construction upon these documents, and to interpret their meaning, rather than to take the interpretation of the witness, particularly in view of the fact that he was not then connected with the commission's work.

Judge CARLAND. I understood the witness to be simply narrating the proceedings which were taken by the commission for the purpose of ascertaining the information upon which they could base a rule for treating these accounts. I do not suppose that the contents of these circulars which the witness mentions are material at all to the inquiry. Are they?

Mr. WICKWIRE. Well, the witness has stated that he expects to file these in connection with his testimony, and if they are material they speak for themselves. One of the statements which he has read from his memorandum is as to what the theory and scheme of these matters was.

Judge CARLAND. Perhaps it would be better for the witness to simply characterize the incidents in a general way, without putting his construction on them.

Mr. DENISON. I thought that was what he was doing. He was simply describing the papers to make them intelligible.

Mr. NEEDHAM. This witness is introducing those because he is the officer in charge of the department in charge of those records, and was familiar with them at that time, because he was on the commission and one of the accounting officers that was consulted about these matters. The evidence is admissible, it seems to me very clear, upon the issue which the petitioner tenders, which is that the action of the commission is arbitrary.

Judge CARLAND. Of course, when the document is admitted the language will control as to what it is.

Mr. NEEDHAM. Surely.

Judge CARLAND. I do not think the witness has done anything objectionable now.

Mr. WICKWIRE. I would like to have it understood that any statements of the witness giving his construction of any of these legal documents, or speaking of his own ideas as to what the purpose of the commission were, be received under objection. I do not wish to be in the position of conceding that that is competent testimony. Some of the papers which the witness has read are not responsive to any direct question, and I therefore had no opportunity to object to them until after the statements had appeared.

Mr. DENISON. Then you move to strike out the exhibits?

Mr. WICKWIRE. No.

Mr. DENISON. That he has referred to?

Mr. WICKWIRE. No.

Mr. DENISON. Do you move to strike out the description of them?

Mr. WICKWIRE. If deemed pertinent, I have no objection to the witness but at the same time it is hardly correct to allow the witness to put his interpretation upon these. If the last statement which the witness read may be read by the stenographer, I think it will indicate to the court the situation.

Will you please read it?

The REPORTER (reading):

The words "income account" and "construction account" were then used to designate, respectively, accounts representing the current revenues and items of income and the current operating and other expenses of the corporation on the one hand, as distinguished from the expenditures on account of the property investment of the carrier on the other.

Mr. WICKWIRE. The witness is now assuming to state the significance attributed by the commission to language in those documents, and it seems to me the documents should speak for themselves. If they state that those terms are used broadly, that will be one matter for the court to consider. If, however, that does not appear in the documents themselves, I do not think this witness's construction of those documents should go into the record.

Mr. NEEDHAM. With reference to that, your honor, as I understand the rule, where a document of this kind uses a technical phrase applicable to an art, it is perfectly competent for any witness who has had to do this, to act upon it, to give his understanding of it. It does not determine the matter at all. Of course, the court, as your honor has well said, will determine it finally upon the record itself, that is, upon the document itself, but when words are used which are peculiar to an art, and that is the case here, where an accounting phrase is used with reference to a classification, it is competent not only for this witness, but for any witness that may have had to do with it and has had to act upon it, to give his understanding of what that includes. I have asked that question of two or three of their witnesses.

Judge CARLAND. I understand that this document, concerning which you have used this language, was sent out from the office at the time you were in charge?

The WITNESS. No, your honor; that came out before I assumed service with the commission.

Mr. NEEDHAM. But he was an accountant for a railroad and a member of this committee to whom it was directed.

The WITNESS. That is true.

Mr. NEEDHAM. So that he had to do with it.

Judge CARLAND. Yes; but he was not in a position to state how the commission used those words in the document. I think the witness ought to restrict his testimony to describing the document of which he was not the author.

Mr. WICKWIRE. I will move to strike out the last statement of the witness.

Judge CARLAND. It may go out.

The WITNESS (continuing). The replies to this circular indicated quite a diversity of practice with respect to the treatment of the element of depreciation of property on the one hand and of additions and betterments to property on the other. It appeared clear

Mr. WICKWIRE. One moment. Is it the purpose to introduce these replies, and thereby to show what they contained?

Mr. NEEDHAM. So far as we have those letters, they can be called for if you desire. We have not thought of introducing them, because I assumed from the testimony which has already gone in and from the general knowledge of the situation that there was a difference of opinion, as was indicated, for instance, in the action in the Buffalo meeting and at the Atlantic City meeting of the accountants. There was a division between the accountants as to what treatment ought to be made, and that same division of sentiment was reflected in replies which they got back, as was shown in the meeting of the committee of twenty-five. I did not suppose there was any question about the fact that there was a division of opinion between the accountants as to how this particular question of abandoned property should be treated.

**Mr. WICKWIRE.** We have never seen these replies and know nothing about this matter, and I think we may properly insist that, if those replies are material for any purpose, they should be presented here and offered in evidence. I therefore move to strike out the last statement of the witness as immaterial and incompetent and as endeavoring to state the contents of written documents.

**Mr. NEEDHAM.** We do not desire to have the contents of these letters stated, and, as I say, I have not thought of presenting them. The only fact that we desire to present to the court in this connection is that there was a division of sentiment. That is all we care for.

**Judge CARLAND.** I think perhaps you had better ask the question of the witness. I will grant this motion to strike out what the witness said as to what these replies were.

**By Mr. DENISON :**

**Q.** Was there a division of sentiment, Mr. Lutz, presented to the commission on the question?—**A.** There was. I may say also that when I was attending the meetings of the committee of twenty-five, representing my then employer, the Louisville and Nashville Railroad, it was within my knowledge, as a person present at the meetings of that committee, that there was quite a diversity of practice among the carriers represented on that committee in their treatment of the element of depreciation on the property on the one hand and of additions and betterments to property on the other. It appeared clear from that discussion that many roads were not making, in my judgment, adequate provisions for depreciation through current charges to operating expenses or elsewhere in the income account.

**Mr. WICKWIRE.** Now, I shall have to object to that statement. I regret to do it, but the witness says "it appeared clear." If there is anything there that is material, I think he should state what was said and not give his conclusion that certain things appeared clear. They might have been clear to one party and very indistinct to some one else. They might not have been at all apparent. I think I shall have to ask to strike that out. If that is material, he should be asked what was said.

**Mr. NEEDHAM.** Is not that a matter of cross-examination? The fact and only fact that we are especially interested in is that there was a difference of opinion in that committee of expert accountants. Now, if counsel desires on cross-examination to ask him with reference to the attitude of particular roads, as represented in the committee, all right, but I do not think we should be compelled in direct examination to go through the list of those roads represented and show how each one stood. It is a fact that there was this difference of opinion. It has already been stated by the witness on the stand. The issue was, Shall these things remain in property account? The next issue was, If they are not to remain in property account, where shall they be charged out—to profit and loss or to operating expenses? These were the only questions involved.

**The COURT.** I will overrule the objection.

**Mr. WICKWIRE.** I note an exception.

**The WITNESS (continuing).** It appeared clear that many roads were not making adequate provisions for depreciation through current charges in operating expenses or elsewhere in the income account, and that, on the other hand, many other roads were overcharg-

ing their operating-expense accounts by including therein sums expended for additions and betterments which served to increase the value, capacity, and efficiency of a carrier's property.

Mr. WICKWIRE. If your honor please, I move to strike out that statement, for several reasons. In the first place, it is a statement of the witness that certain things appeared clear, and then he says it appeared clear in his judgment of things, and it is a mere conclusion of the witness and is not a statement of any issues of the fact. It seems to me it is highly incompetent to lumber up this record with something in the nature of mere conclusions.

Mr. DENISON. Your honor, may I ask a qualifying question before you rule upon that?

The COURT. Yes.

By Mr. DENISON:

Q. Mr. Lutz, were these rules promulgated by the commission in part on your advice as its officer?—A. They were.

Q. And in rendering that advice to the commission were the matters which you have just referred to a part of the considerations which actuated you?—A. They were.

The COURT. I deny the motion. I do not think there is anything there that is very far out of the way.

Mr. WICKWIRE. I note an exception.

The WITNESS (continuing). It was therefore sought to prescribe such a definition of operating expenses as would include in the accounts therefor the full cost but no more than the cost of maintaining the property and of performing the service of transportation. In consideration of the cost of maintaining the property it was believed that included therein should be not only the cost of current repairs made in keeping the property in proper condition for operation but as well the cost of replacing it when abandoned or retired from service.

In furtherance of the principle of including in operating expenses the cost of replacing property retired as well as in recognition of the importance of having periodical statements of net earnings from operation include as charges to operating expenses proper provision for the expiration of value of property used in operation, careful consideration was given to the matter of the establishment of accounts for depreciation charges to take care of the value of property lost in operation. Accounting series circular No. 8, issued by the Division of Statistics and Accounts of the commission, was sent to all accounting officers of steam railways under date of April 10, 1907. A copy of this circular will be filed, marked "Exhibit C. A. L. No. 1." Inasmuch as this circular suggests the position of the commission with respect to depreciation, it may not be inappropriate to quote the more significant portions thereof referring to this subject. The first full paragraph on page 2 reads as follows:

The depreciation for which provision should be made covers the value of the property abandoned, less the value of the scrap at the time of its abandonment. The cause of this abandonment is of no importance. It may be that general wear and tear has gone so far that it will not pay to make further repairs or further renewal of parts; it may be that development in the art of transportation has

<sup>1</sup> Not printed in record.



made it undesirable to continue the use of the type of property in question. The point is that there must be a replacement of old property by new property, and it is essential that provision should be made out of the earnings of the property during the period of its use to replace it when abandoned. To do less is to fail to maintain the property; to do more is to state erroneously the cost of transportation. The purpose of a depreciation charge is to provide a replacement fund.

One of the purposes of this circular was to suggest to carriers that, beginning on July 1, 1907, provision be made in the accounts for operating expenses for a definite per cent of the original cost of property in order to create a fund to replace such property when it disappears from service. On account of the difficulty in determining a uniform rate per cent to be used which would be applicable to all carriers, the determination of the percentage was left to the carriers making report, but it was contemplated that each carrier should be required to submit a detailed statement in defense of whatever charge was set up.

If your honor please, I would like to be allowed to strike out a few words there—"on account of the difficulty in determining a uniform rate per cent to be used which would be applicable to all carriers"—

MR. WICKWIRE. May I inquire why the witness wishes to strike that out?

THE WITNESS. Primarily because that represents a fact that is not entirely within my knowledge. I do know that it was determined not to do that, but there may have been other considerations which led to the determination of that course.

MR. WICKWIRE. Well, do you know of any other considerations which did lead to that determination?

A. Not personally; no.

THE COURT. This is a quotation from a document that you are to file as an exhibit?

THE WITNESS. No, your honor. This is my statement. My quotation ended some time ago.

THE COURT. This is your own testimony?

THE WITNESS. Yes.

THE COURT. Of course, in giving the testimony, the witness may give as much or as little as he pleases.

MR. WICKWIRE. Was the testimony accurate as originally given by you?

THE WITNESS. I think it probably was not. For that reason I desire to correct it.

MR. WICKWIRE. Do you know of any fact which makes the statement incorrect?

THE WITNESS. Except that it is not entirely within my knowledge.

The determination of the percentage was left to the carriers making report, but it was contemplated that each carrier should be required to submit a detailed statement in defense of whatever charge was set up. It was at that time thought desirable to provide in the operating expense classification depreciation accounts to provide funds for replacement of the following classes of property:

Ties; rails; bridges, trestles, and culverts; buildings, fixtures, and grounds; docks and wharves; work equipment; steam locomotives; electric locomotives; passenger-train cars; freight-train cars; floating equipment.



While it was stated that it was regarded that the foregoing were the most important classes of property subject to depreciation, it was suggested that carriers would be at liberty to set up depreciation accounts for all other classes of property if they so desired. Careful consideration was given to the responses received to this circular, and the questions involved were fully discussed with the committee of twenty-five until the classification of operating expenses was submitted to the commission and issued under order effective on July 1, 1907.

MR. WICKWIRE. One moment. I would like to ask if the last sentence is within the witness's own knowledge?

MR. NEEDHAM. He was a member of the committee.

MR. WICKWIRE. I would like to ask him a question.

By MR. WICKWIRE:

Q. Were you ever a member of the committee of twenty-five?—A. Not a member of the committee, but I frequently attended its meetings as representing, and sometimes in company with, my then superior officer, Mr. Charles Haydon, the comptroller of the Louisville and Nashville Railroad. He was a member of the committee.

Q. But this last statement which you have read purports, as I understand it, to speak about the consideration given, and I will ask if that is within your personal knowledge.

MR. NEEDHAM. He was in charge at the time this classification was issued.

THE WITNESS. Not at this time.

MR. NEEDHAM. What classification are you referring to now?

THE WITNESS. Classification of operating expenses.

MR. NEEDHAM. That was 1907.

THE WITNESS. I suppose I could not say that was within my personal knowledge. I knew it, of course, in a general way, as I knew these discussions were going on, and knew that my chief was in attendance upon these meetings, and kept closely in touch with the subject matter of the discussions, as reflected in the bulletins of the association.

MR. NEEDHAM. Let us get clearly the time when you came into the commission and took up these revisions as the accounting officer for the commission and had occasion to examine these questions. When was that?

THE WITNESS. June 16, 1908.

MR. NEEDHAM. Yes.

THE WITNESS. It was determined when the classifications were issued (and this determination was reflected in the classifications as issued) to restrict the classes of property for which formal depreciation accounts were provided to rolling-stock equipment.

At this point, it may be well to quote from a paper prepared by Mr. Henry C. Adams, entitled "Administrative supervision of railways under the twentieth section of the act to regulate commerce," published in the Quarterly Journal of Economics for May, 1908, viz: (Extract missing.)

MR. WICKWIRE. I do not see that that is competent testimony in this case.

THE COURT. No; I think that is objectionable.

By Mr. DENISON:

Q. Who was Mr. Adams?—A. Mr. Adams at that time was in charge of the Bureau of Statistics and Accounts for the Interstate Commerce Commission. That paper was published a very short time before I became connected with that bureau.

Q. It was published in the Quarterly Journal of Economics for May, 1908, was it not?—A. Yes, sir.

Q. Was Mr. Adams an expert accountant?—A. I think he had better answer that.

Q. Do you know him by reputation?—A. I do.

Q. Is he reputed to be an authority on accounting?—A. He is reputed to be an authority on economics. I think perhaps he had better answer as to his experience respecting accounting.

With reference to the development of the additions and betterments classification, it may be stated that the committee of twenty-five prepared a tentative classification of additions and betterments which was published in bulletin No. 28 of that committee under date of June 19, 1907, the conclusions of the committee on this tentative classification and text therefor having been arrived at in the meeting in Buffalo, New York, held on June 13 and 14, 1907, at which I was present in company with my then superior officer, Mr. Charles Haydon, comptroller of the Louisville & Nashville Railroad Company, and a member of this committee.

I file a copy of this bulletin—

Q. (Interrupting.) That is the one already in evidence as respondent's Exhibit C, is it not?—A. Yes, sir.

Q. Bulletin No. 28, which is this same document?—A. Yes, sir; that is the same document.

This tentative classification provided the following account and text for grade revisions and changes of line:

Grade revisions and changes of line.

To which account should be charged, grade revisions

Q. (Interrupting.) The passage to which you are referring is a passage which bears that title in bulletin No. 28?—A. That is true.

Q. Then you may dispense with the reading of it, as it is already in evidence.—A. I think the resolution of the committee at Buffalo, in which it was stated that the matter of classification of additions and betterments includes matters of financial policy, is also in evidence, is it not?

Q. Yes; it is in bulletin No. 28.—A. Then I will pass that, too.

Subsequently the chairman of the committee submitted the tentative classification to the representative of the Interstate Commerce Commission on July 1, 1907, together with a number of letters from executive and accounting officers of railways, and accordingly on July 5, 1907, it was issued by the commission in the form of accounting series circular No. 11, which was sent to all accounting officers with the idea of soliciting further criticisms and suggestions with respect to the provisions of the proposed classification.

A copy of this circular is filed, marked "Exhibit C. A. L., No. 8."

Q. Is it already marked?—A. I have already marked it "No. 8."

## RESPONDENT'S EXHIBIT C. A. L. No. 8.

[Printed in part.]

Accounting series circular No. 11.

## INTERSTATE COMMERCE COMMISSION.

## DIVISION OF STATISTICS AND ACCOUNTS.

Washington, July 5, 1907.

DEAR SIR: On June 13 and 14, 1907, the standing committee on corporate, fiscal, and general accounts of the Association of American Railway Accounting officers met for the purpose of passing upon a tentative classification of additions and betterments expenditures. At this meeting the following resolution was adopted:

"*Resolved*, It is the sense of this standing committee that before this bulletin is submitted to the Interstate Commerce Commission that such members of the association as desire to submit the same to their executive officers for any suggestions be permitted to do so and have their answers to the chairman of this committee, Mr. A. H. Plant, comptroller, Southern Railway, Washington, D. C., before the 1st of July, 1907, and that the letters submitted to the chairman of this committee be transmitted to the Interstate Commerce Commission with the classification and text."

In accordance with the above resolution, it was not until July 1 that the chairman of the committee on corporate, fiscal, and general accounts was authorized to submit to the Interstate Commerce Commission the tentative classification adopted.

A cursory examination of this classification, as also of the letters by which it was accompanied, leaves the impression that there are quite a number of principles involved that require further consideration before they can with propriety be promulgated under a formal order of the commission. The importance of this classification as an integral part of a system of operating accounts leads to the same conclusion. This being the case, it is thought wise to issue the classification in the form of a circular, with the suggestion that for the present the general principles here laid down may be followed by accounting officers, but that no accounting officer should be required to make radical changes in past methods of accounting, so far as the expenditures under consideration are concerned.

It should, however, be distinctly understood that the liberty thus granted must not be construed as authorizing that expenditures which are manifestly of the nature of additions and betterments may be charged to operating expenses; and in general it may be said that in case of conflict between the text of the classification here submitted and the instructions contained in the several classifications issued under order of the commission, the instructions should govern.

In the reprint of this classification of additions and betterments expenditures, sufficient space has been provided under each primary account to allow for the insertion of criticisms or suggestions for further change. Accounting officers are earnestly requested to consider with care the principles underlying this classification, as also the text in which these principles are expressed, and make replies accordingly. Such replies should be made in duplicate, one copy to be forwarded to Mr. C. G. Phillips, secretary, Association of American Railway Accounting Officers, 143 Dearborn Street, Chicago, Ill., and the other to the Division of Statistics and Accounts, Interstate Commerce Commission, Washington, D. C.

It is desired that replies to this circular be made not later than September 15, 1907.

Respectfully,

HENRY C. ADAMS,

*In Charge of Statistics and Accounts.*

## TENTATIVE CLASSIFICATION OF ADDITIONS AND BETTERMENTS EXPENDITURES AND TEXT THEREFOR.

## GENERAL INSTRUCTIONS.

For the purpose of making annual reports to the Interstate Commerce Commission, charges to the following accounts should be separated between "additions" and "betterments." "Additions" include additional structures, facilities, or equipment not taking the place of anything previously existing. "Betterments" include the enlargement or improvement of existing structures,

facilities, or equipment, or the proper portion of the cost of new structures, facilities, or equipment of an improved or higher class taking the place of others previously existing.

In addition to reporting to the Interstate Commerce Commission each year the total expenditures for "additions" and for "betterments" in accordance with the following classification, carriers should also report the total expenditures for "additions and betterments," classified in accordance with the list of accounts provided for in the classification of expenditures for road and equipment.

The minimum charge to "additions and betterments" for a building, bridge, or other structure or improvement thereto, or for any other individual piece of work, except as herein further provided, shall be \$200. Expenditures amounting to less than \$200, except as herein further provided, should be charged to the appropriate account under operating expenses or outside operations.

It is understood that the final assignment of the total of "additions and betterments" expenditures between income, capital, or special funds may be determined by the financial policy of individual carriers.

Credits to "additions and betterments" to cover the original cost (actual or estimated) of structures, facilities, or equipment removed, abandoned, or taken out of service and not replaced, should be assigned to income, capital, or special funds, in accordance with the assignment of the original cost of such structures, facilities, or equipment.

*NOTE.* The classification of expenditures for road and equipment applies exclusively to the construction and equipment of new main and branch lines and extension of existing lines.

#### TENTATIVE CLASSIFICATION OF ADDITIONS AND BETTERMENTS EXPENDITURES.

1. Right of way and station grounds.
2. Real estate.
3. Widening cuts and fills.
4. Protection of banks.
5. Grade revisions and changes of line.
6. Tunnel improvements.
7. Bridges, trestles, and culverts.
8. Increased weight of rail.
9. Ballast.
10. Additional main tracks.
11. Sidings and spur tracks.
12. Terminal yards.
13. Fencing right of way.
14. Improvement of over and under grade crossings.
15. Track elevation, elimination of grade crossings, etc.
16. Interlocking apparatus.
17. Block and other signal apparatus.
18. Telegraph and telephone lines.
19. Station buildings and fixtures.
20. Shops, engine houses, and turntables.
21. Shop machinery and tools.
22. Water and fuel stations.
23. Grain elevators and storage warehouses.
24. Dock and wharf property.
25. Electric light and power plants.
26. Electric-power transmission.
27. Gas-producing plants.
28. Snow and sand fences and snow sheds.
29. Miscellaneous structures.
30. Reconstruction of road purchased.
31. Steam locomotives.
32. Electric locomotives.
33. Passenger-train cars.
34. Freight-train cars.
35. Work equipment.
36. Floating equipment.
37. Interest, discount, and commission.

## 5. GRADE REVISIONS AND CHANGES OF LINE.

To this account should be charged:

**GRADE REVISIONS.**—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment. The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels, and grading outfits, tools used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences, buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway crossing alarms, and watch houses.

**NOTE A.** *The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; rebalasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection; should all be charged to appropriate operating-expense accounts.*

**NOTE B.** *When, in reducing grades, grade crossings are eliminated and overhead crossings substituted therefor, the cost of grading the highway or street approaches to the new crossings, the overhead bridge with its abutments, piers, and posts, should all be charged to account, "Track elevation, elimination of grade crossings, etc." In case undercrossings are substituted for grade crossings, the cost of the undercrossing is a portion of the cost of the grade revision and should be charged to this account.*

**CHANGES OF ALIGNMENT.**—Cost of changing alignment for purposes of reducing curvature, cutting out bridges, tunnels, etc. The amount to be charged to this account for work of this description is the excess cost of the grading and bridging done, over the actual cost or, if actual cost is unknown, estimated original cost of that portion of the grade, bridges, tunnels, etc., on the old line that will be abandoned or rendered unnecessary.

**NOTE.** *The explanations given under "Grade revisions" as to the items constituting cost of grading, the portion of that cost and of the cost of track work of all kinds chargeable to operating-expense accounts, and as to charging the cost of new overhead crossings, apply equally to "Changes of alignment."*

**CHANGES OF LINE.**—Cost of building new lines (exclusive of cost of right of way therefor, which should be charged to account, "Right of way and station grounds") for the purpose of improving both grade and alignment, over the actual cost, if known, or estimated original cost, if actual cost is unknown, of the line to be abandoned. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs, switches, track fastenings, and other track material; ballast, tracklaying, and surfacing, fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovels, and other work equipment, locomotives, cars, and crews employed in the work.

**NOTE A.** *Cost of buildings, water and fuel stations, and similar structures on new lines should not be charged to this account which is intended to cover the roadway and track only, but should be charged to the appropriate additions and betterments and operating-expense accounts, as provided for in the various accounts herein relating to the different classes of buildings and structures.*

*The actual or estimated original cost, as the case may be, of the line to be abandoned, exclusive of right of way and station grounds and of buildings as above, with the cost of removal of tracks, bridges, etc., less salvage, should be charged to the appropriate operating-expense accounts.*

**NOTE B.** *All expenditures charged to account, "Grade revisions and changes of line," should be classed as "betterments."*

\* \* \* \* \*

## 20. SHOPS, ENGINE HOUSES, AND TURNABLES.

*NOTE.*—*Expenditures charged to this account will be classed as "additions" or "betterments" according to the following definitions:*

**ADDITIONS.** To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); engine houses (including turntables and cinder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and out-houses in connection with additional buildings; additional oil houses, sand houses, storehouses for company's material, scrap bins, appurtenances, etc.; also cinder pits, drop pits (outside of engine houses), and turntables where none before existed. This account should include amounts paid when erected by contract; labor and material when built by company; preparing grounds before and clearing up same after construction; foundations and painting; excavation for and lining of additional turntable pits and of cinder or drop pits inside or outside of additional engine houses; foundations for additional turntables; loading, unloading, and placing turntables in position; levers, tractors, and stops for handling turntables; sewerage systems, connection with water-supply system, and shop wells for additional buildings; architect's fees for drawing plans for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses and cost of all tracks laid in any additional building above described, on transfer tables and turntables in connection with such additional buildings and leading from such transfer tables or turntables into additional shops and engine houses.

When shop buildings (with their appurtenances as above described), engine houses, or turntables are removed and not replaced, the original cost thereof or, if original cost is unknown, their estimated original cost should be credited to this account and charged, less salvage, to the appropriate operating-expense account, to which account should also be charged the cost of their removal and of restoring the grounds to proper condition, including filling foundations, wells, turntable pits, etc.

**BETTERMENTS.**—To this account should be charged the excess cost of new buildings to be used as shops, car sheds, or engine houses, and of new transfer tables, turntables, cinder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for furnishing power or for heating and lighting existing shop buildings, engine houses, etc., when such plants are not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, sidewalks, and out-houses in connection with existing shop buildings or engine houses; excess cost of enlarging, altering, or rebuilding oil houses, sand houses, storehouses for company's materials, scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing engine houses where no pits previously existed; tractors or other apparatus for handling existing turntables; enlarging and deepening shop wells; excess cost of reconstructing water-supply and sewerage systems for shops and engine houses over cost of replacing the existing ones; cost of fences and hedges on or around existing shop grounds or buildings, where not previously fenced; all expenses incident to paving and draining existing shop grounds or grounds around existing shop buildings, engine houses, etc.; and excess cost of extending, re-railing, or relaying tracks in shop buildings or engine houses, on transfer tables or turntables in connection therewith, or of tracks leading from such transfer tables or turntables into shop buildings or engine houses, over the cost of replacing the existing tracks.

The criticisms and suggestions received in response to accounting series circular No. 11 were made available for the committee of twenty-five, and the classification received its further consideration at various meetings during the fiscal year ending June 30th, 1908.

At a meeting held at Atlantic City, New Jersey—

Q. (Interrupting.) Among the replies received from railroad officials to accounting series circular No. 11, was there one from the second vice president of the Great Northern Railway, dated October 2, 1907?—A. There was.

MR. DENISON. I offer that in evidence.

MR. WICKWIRE. That is objected to as immaterial.

Is it your purpose to offer all the replies received, or just a portion?

MR. DENISON. These are all at your disposal. Those we are interested in are those which approve the plan subsequently adopted by the commission, and which thereby say that the plan was not unreasonable.

MR. WICKWIRE. I object to these, if the court please, as wholly immaterial and not a proper issue in this case.

If counsel should desire to offer them all for the information of the court, it might be a somewhat different matter; but it seems to me he has no right to introduce any of them. If the attitude assumed by any of the officials who may have signed these replies is material to any issue in this case, they should be produced here for cross-examination and we should not be required to confront their statement of opinion without an opportunity to cross-examine them as to their reasons for their opinions. It seems to me these are mere hearsay and quite irrelevant.

THE COURT. I think I shall be obliged to sustain the objection.

MR. DENISON. Of course, your honor understands fully that they are offered as showing a part of the basis before the commission for its action. They are letters which were submitted to the commission before it took its action, and were a part of the consideration which the commission gave to the subject and which led to its action. Our position is that they go directly to show that it did not act without due consideration, without a proper basis, or arbitrarily.

THE COURT. Is it charged in the petition that they did?

MR. DENISON. That is what I understand, that it is the effect of the petition, that the commission promulgated rules unreasonably. I understand the purport of the proceeding to be that this commission exceeded its legal powers because it took action without a proper basis. The theory on which I offer the testimony of Mr. Lutz is to show the investigations which the commission made before it made these rules, in order to show that it did not act without due consideration.

MR. WICKWIRE. It is not a question of whether the commission gave careful and deliberate consideration and whether they read everything upon the subject that they could. The question is whether they acted according to the proper principles of law and accounting or whether they did not.

THE COURT. Will you call my attention to the parts of the petition which refer to the matter?

MR. NEEDHAM. You will find it on page 34 of the petition, as follows:

Your petitioner alleges that in so far as the above-mentioned alleged orders and classifications of the Interstate Commerce Commission require your petitioner to charge to its operating expense and profit and loss accounts the estimated replacement value (less salvage) of the portions of its line of railroad abandoned as an incident to improvement in grade, said alleged orders and classifications are unreasonable and beyond the power and authority of the commission, and are null and void.

There are other allegations in the petition to the same effect, but it rests entirely, as I understand the issue tendered by the petition, upon the proposition that these orders are either outside of the power of



the commission under the statute, or if they are within the power, that they are arbitrary or unreasonable.

Mr. DENISON. I also call your honor's attention to the answer of the United States, in articles 2 and 3, in which it is set up that the commission acted only after full consideration of all points of view affecting the situation and after full consideration of all the facts, and after consultation with the persons conversant with methods, practices, and requirements of railway accounting. That is the answer of the United States. Substantially the same allegations are contained in the answer of the Interstate Commerce Commission.

Mr. WICKWIRE. If your honor please, the fact that the Great Northern Railway Company may have been satisfied with this regulation, if that were the fact, is wholly immaterial upon the question of the reasonableness or unreasonableness as a matter of law of the action of the commission. The question here is one of law, and the opinion expressed by some individual is in no way pertinent to the question of whether the commission acted reasonably or unreasonably. Further, it seems to me it would be distinctly unfair to allow to go into the record here the unverified statements of some gentleman in St. Paul who is not here for cross-examination.

The COURT. I will adhere to my former ruling. It is presumed that the commission gave all the consideration that the law and its duty required. The petition does not attack the order of the commission on that ground, but it says that the rule itself is unreasonable.

Mr. DENISON. Will your honor allow me an exception?

The COURT. Yes, sir.

Mr. DENISON. May I have this letter marked for identification as "Respondent's Exhibit D?"

The COURT. Yes.

The letter referred to was thereupon marked "Respondent's Exhibit D," for identification.

Mr. DENISON. I also offer on that same line a letter from the general auditor of the Atchison, Topeka & Santa Fe Railway System, dated October 2, 1907.

By Mr. DENISON:

Q. This letter, Mr. Lutz, is one of the same group of letters, is it not?—A. It is.

Q. And was a part of the matter submitted to the commission and considered by the commission in connection with the rules referred to?—A. It was.

Mr. NEEDHAM. I should like to have it appear in the record on the part of the commission that these letters are offered as showing a part of the investigation that was made by the commission, and for that purpose.

The COURT. Very well.

Mr. WICKWIRE. I enter the same objection, your honor.

The COURT. I make the same ruling.

Mr. DENISON. And exception, your honor.

The COURT. Yes.

You had better offer them all, if you have several.



Mr. DENISON. The one I have just referred to may be marked "Respondent's Exhibit E." for identification.

The letter referred to was thereupon marked "Respondent's Exhibit E." for identification.

Mr. DENISON. I offer similar letters to be marked "Respondent's Exhibits F, G, H, I, and K."

Mr. WICKWIRE. We make the same objection.

The COURT. The same ruling.

Mr. DENISON. And exception?

The COURT. Yes.

The letters referred to and offered and refused, were thereupon marked, respectively, "Respondent's Exhibits F, G, H, I, and K, for identification."

The COURT. In order that the reviewing court may pass upon the question without receiving these in evidence, counsel ought to state and let it go into the record what these letters were.

Mr. DENISON. I said similar letters. That is what I intended to do, but I thought your honor asked me not to do so, but to put them in in a lump.

However, I will state that "Exhibit F, for identification" is a letter from the assistant comptroller of the Louisville & Nashville Railroad Company, dated June 29, 1907.

By Mr. DENISON:

Q. That was signed by you, Mr. Lutz, as assistant comptroller?—A. It was.

Q. That was your position then?—A. It was.

Mr. DENISON. "Exhibit G, for identification" is a letter from the general auditor of the Atchison, Topeka & Santa Fe Railway System, dated June 25, 1907.

"Exhibit H, for identification" is a letter from the president of the New Orleans & Northeastern Railway Company, dated June 27, 1907.

"Exhibit I, for identification" is a letter from the comptroller of the Baltimore & Ohio Railroad Company, dated July 1, 1907.

"Exhibit K, for identification" is a letter from Price, Waterhouse & Company, chartered accountants, dated September 18, 1907.

Also in the same line I offer as "Exhibit L, for identification" a similar letter from the president of the Chicago, Burlington & Quincy Railroad Company, dated September 17, 1908; also one from the fourth vice president of the Atchison, Topeka & Santa Fe Railway System, dated September 21, 1908; also one from the president of the Great Northern Railway Company, dated September 8, 1908; and ask that these last three letters offered be marked respectively "Respondent's Exhibits L, M, and O, for identification."

The three letters referred to were thereupon marked, respectively, "Respondent's Exhibits L, M, and O, for identification."

The COURT. You ought to state, so it may show in the record, what the general purport of these letters is.

Mr. DENISON. These are letters which advised the commission or the committee of twenty-five, and submitted by that committee to the commission, that the proposed classification, which is now in

controversy, met with their approval, with the approval of the writers of the letters. These letters were written in the course of the investigation made by the commission in its study of the question of what was a proper method of accounting in this particular.

By Mr. WICKWIRE:

Q. A considerable number of these letters are addressed, not to the commission or to any of its representatives, but to Mr. Plant as chairman of the committee, are they not?—A. That is true.

Q. Am I to understand that each and all of these documents, including these personal letters to Mr. Plant, were before the Interstate Commerce Commission at the time it considered these matters?—A. They were before the representative of the commission; yes, sir.

By Mr. DENISON:

Q. Mr. Plant turned these letters over to the commission, did he not?—A. That is true, in pursuance of a resolution adopted by the committee of twenty-five at this Buffalo meeting, which provided that such members of the association as desired to submit the proposed classification to their executive officers for any suggestions, be permitted to do so, and to have their answers with the chairman of the committee, Mr. Plant, before the 1st of July, 1907, and that the letters submitted to the chairman be transmitted to the commission with the classification and text.

That was done and a number of letters were submitted to the committee, which were subsequently transmitted to the representatives of the commission by Mr. Plant, the chairman of the committee. They were not all submitted before July 1, 1907. Some of them came a little later. Attached to the file will be found some letters that were written later, in 1908. Those, if my memory serves me correctly, were addressed to the commission in response to a general letter sent out by the commission to the executives of prominent carriers throughout the country, under date of August 1, 1908, which it was my purpose to refer to later.

By Mr. WICKWIRE:

Q. Are you able to state that this "Exhibit I, for identification" was before the commission for its consideration before July 1st? It is dated July 1st.—A. I cannot. I do not think I said anything that would justify that conclusion.

Q. I understood counsel to have offered these as part of the matters which were considered by the commission prior to July 1, 1907.—A. Perhaps I can explain that, if counsel will permit.

The classification of additions and betterments was not prescribed under an order of the Interstate Commerce Commission until July 1, 1909. It was sent out as an accounting series circular shortly after the receipt of some of these letters. Perhaps all of the letters were not in hand before it was sent out. It was sent out, however, without any change, as recommended by the Buffalo meeting of the committee, the purpose being to elicit further criticism and suggestions from any accounting officer who might be interested, and to get the benefit of whatever suggestions might have been had from others than members of the committee of twenty-five.

Mr. WICKWIRE. If the court please, I make the same objection to these additional documents.

The COURT. It will be understood——

Mr. NEEDHAM. I would like to bring out very clearly, if it is not already understood, that before the order in 1909, Mr. Lutz had come to the commission, and in his position as head of the accounting department he had occasion to review all of these letters from the standpoint of the commission before the order was finally entered and classification finally adopted. If there is any doubt about that, I should like to have Mr. Lutz state it.

By Mr. NEEDHAM:

Q. That is a fact, is it not, Mr. Lutz?—A. It is.

Mr. DENISON. I understand all these offers are excluded?

The COURT. Yes.

Mr. DENISON. And an exception is allowed?

The COURT. Yes.

By Mr. DENISON:

Q. Were you present at the Buffalo conference?—A. I was.

Q. Was the question that is in issue here in this case discussed at that conference in your presence?—A. Meaning the disposition of charges for abandoned property?

Q. Yes.—A. The general idea of restricting the charges to additions and betterments—and by that I mean charges to property accounts—to the excess cost of new and improved property over the cost of property replaced by such new and improved property, was ~~rather~~ fully discussed at that meeting.

Q. And that is the question that lies at the foundation of this case, is it not, as you understand it?—A. That is my understanding.

Q. Was there a difference of opinion at that conference on that subject?—A. There was.

Q. When it came to a vote, which opinion preponderated—that which is in accord with the position which the Interstate Commerce Commission finally took, or the opposite?—A. I should say that the results of that meeting, as reflected in bulletin No. 28, were substantially in accord with the position finally taken and adopted by the commission.

Q. Do you recollect approximately how the vote stood?

Mr. WICKWIRE. I would like to move to strike out that answer as being a mere conclusion of the witness. He states that it is his opinion that the results were substantially in accord with something else. I think we ought to have a statement of facts.

Mr. NEEDHAM. What do you mean by "something else?"

Mr. WICKWIRE. The position taken by the commission.

Mr. DENISON. Is it really controverted that bulletin No. 28 indicates the position which is substantially the same as the rules ultimately adopted?

Mr. WICKWIRE. It is controverted that the committee took any definite position inconsistent with the position which they revealed subsequently.

Mr. NEEDHAM. That speaks for itself, if your honor please. The action of the committee is reflected in its resolution. The witness said he understands them to be in accord with the commission. That

is his interpretation of it, of course. I think it is perfectly competent for him to answer that question as to how he understands the result.

Mr. WICKWIRE. The record of what was done at that meeting has already been introduced and speaks for itself. Counsel, upon cross-examination of Mr. Plant, inquired of him, and that has been introduced. It seems to me this witness's conclusion as to whether the action of that committee was consistent or inconsistent with a subsequent position taken by the commission is entirely incompetent.

The COURT. There is no vote stated in this bulletin No. 28, is there?

Mr. DENISON. There is a resolution stated—that is, it is stated as passed.

The COURT. Perhaps we had better let bulletin No. 28 determine the matter.

By Mr. DENISON :

Q. Did you then discuss the question with members of the committee yourself?—A. That was my first meeting in attendance upon the deliberations of the committee, and I was there in company with my superior officer, Mr. Haydon. I do not recall clearly whether I took the floor at that meeting or not; but my impression is that at times I did.

Q. You heard the discussion?—A. I did.

Q. Did you hear discussion outside of the meeting as well by members of the committee?—A. I think it is fair to say that I did.

Q. Do you know whether or not the resolution contained in bulletin No. 28, referring to the tentative classification attached thereto, did or did not represent the true views at that time of the persons who voted for it, or was it, as has been intimated here, a merely fictitious resolution?

Mr. WICKWIRE. That is objected to, if your honor please, on the ground it is incompetent for this witness to state what were the true views of the members of the committee.

The COURT. I sustain the objection.

By Mr. DENISON :

Q. Do you remember how many were present at the time that resolution was passed?—A. I do not; but that resolution, if my memory serves me correctly, and I think it does, was passed at almost the conclusion of the meeting.

Q. On the first or second day?—A. On the second day. The report of the subcommittee was taken up, as I recall the matter, and read section by section. The recommendations with respect to the text of the proposed accounts were considered section by section and adopted or amended as they were read, section by section. Finally the committee voted upon the adoption of the report as a whole, embodying also as a part of its conclusions this resolution.

Q. The particular paragraph—No. 5, is it not—concerns the relocation of lines?—A. Yes.

Q. Did that come up prior to the passage of the general resolution to which you referred, which was at the end of the second day?—A. Undoubtedly.

Q. These specific paragraphs were taken up one by one before the general resolution was passed?—A. That is true.

Q. Do you recall when that paragraph was taken up?—A. I do not think I could state with great certainty, but I should judge from its position in the classification, being item No. 5, that it was taken up on the first day.

Q. Have you a recollection of what the vote was on that paragraph?—A. I have only a very indistinct impression that with respect to some of the items, which were rather closely voted, that there was a vote of something like ten to nine.

Q. After the Buffalo meeting, what happened?—A. As I said before, the classification, as embodied in bulletin No. 28, was submitted by the commission to all accounting officers, in accounting series circular No. 11, which I have filed.

From time to time, during the period intervening, criticisms and suggestions were received in response to it and were made available for consideration of the committee of twenty-five, and that classification and those suggestions received its further consideration at various meetings throughout the fiscal year ended June 30th, 1908.

At a meeting held in Atlantic City, New Jersey, on July 6, 7, 8, and 9, 1908, it was again considered by that committee and amended in a number of important particulars, among which were changes in the text of the proposed account No. 5—grade revisions and changes of line—so that the text of that account, as amended by the committee at that time and embodied in bulletin No. 33 of that association, issued July 15, 1908, reads as follows—

Q. (Interrupting.) You are filing a copy of that bulletin?—A. Yes, sir.

Q. And the passage in the report is that which is entitled "Grade revisions and changes of line"?—A. That is true.

Q. You may dispense with the reading of it, then.—A. That bulletin will be filed, marked "Exhibit C. A. L. No. 9."

MR. WICKWIRE. Do I understand this bulletin No. 33 is offered now?

MR. DENISON. Yes. I think, in order to economize space in the record, we will restrict the offer to the passage which is entitled "Grade revisions and changes of line."

By MR. WICKWIRE:

Q. I understand that this tentative text of classification, of which subdivision five is entitled, "Grade revisions and changes of line," was adopted by the entire association. Is that correct?—A. That is my understanding.

By MR. DENISON:

Q. You may read that subdivision, Mr. Lutz.

Grade revisions and changes of line.

To this account should be charged:

*Grade revisions.*—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment. The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels and grading outfits, tools used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences, buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway crossing alarms, and watch houses.

**NOTE.**—The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade should be charged to appropriate operating expense accounts.

**Changes of alignment.**—Cost of changing alignment for purposes of reducing curvature, cutting out bridges, tunnels, etc.

**Changes of line.**—Cost of building new lines, exclusive of cost of right of way therefor, which should be charged to account "Right of way and station grounds," for the purpose of improving both grade and alignment. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs and switches, track fastenings, and other track material; ballast, track laying and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools and expenses of steam shovels, and other work equipment, engines, cars and crews employed in the work.

**NOTE.**—Cost of buildings, water and fuel stations, and similar structures on new lines, should not be charged to this account, which is intended to cover the roadway and track only.

At this Atlantic City meeting I was present, in company with Mr. Adams, then my superior in the Division of Statistics and Accounts of the Interstate Commerce Commission, having in the meantime entered the service of the commission.

**Q.** Do you know whether changes made in the classification at the Atlantic City meeting did or did not express the views of the accounting experts present, as accountants?

**Mr. WICKWIRE.** I must object to that, your honor, for the same reason.

**The COURT.** Yes; I sustain the objection.

**By Mr. DENISON:**

**Q.** Did you discuss the matter with the accounting experts present?—**A.** My recollection is that at that meeting the representatives of the commission did not discuss these questions very fully with the members of the committee. We rather sat still and listened at that meeting than entered into the discussion.

**Q.** Did you hear the discussion?—**A.** I did.

**Q.** Do you know whether or not the resolutions were passed owing to pressure from the executive officers of the railroads, rather than as representing the views of the accountants themselves as accountants?

**Mr. WICKWIRE.** That is objected to as immaterial, if your honor please, and as calling for a conclusion of the witness and relating to matters as to which in the nature of things he has no personal knowledge.

**The COURT.** I will sustain the objection.

**Mr. DENISON.** May I note an exception, if your honor please?

**The COURT.** Yes, sir.

**By Mr. DENISON:**

**Q.** In point of fact, do you know whether these resolutions, adopted at the Atlantic City conference in regard to the classification here in question, truly expressed the views of the accountants as accounting experts?

**Mr. WICKWIRE.** I will have to object to that, if your honor please.

**The COURT.** I will sustain the objection.

**Mr. DENISON.** I note an exception, if your honor please.

**The COURT.** Yes. Is it in regard to the resolution introduced here by yourself?

Mr. DENISON. Yes, your honor. It is part of the history.

The COURT. Do you want to introduce it to show it is not good for anything?

Mr. DENISON. I want to show the history of it and the cause of it.

By Mr. DENISON :

Q. Do you know how it came about that that resolution was adopted at the meeting of the Atlantic City conference?—A. The personnel of the—

Mr. WICKWIRE. Wait a moment.

I object to that, if your honor please, as calling for a conclusion of the witness and as immaterial.

The COURT. This is with reference to the resolution which you yourself have introduced, is it?

Mr. DENISON. Yes.

The COURT. The objection is sustained.

By Mr. DENISON :

Q. Do you know of your own knowledge, Mr. Lutz, what brought about the change of view between this last resolution and the resolution adopted at Buffalo?

Mr. WICKWIRE. I object to that as immaterial, your honor.

The COURT. Was he a member of the committee at that time?

Mr. DENISON. He was present and heard the discussion, he states.

The COURT. I sustain the objection.

Mr. DENISON. May I note an exception, your honor?

The COURT. Yes.

By Mr. DENISON :

Q. This resolution is the same one that was put in evidence by the petitioner this morning, is it not?—A. You mean the one with respect to the Atlantic City meeting?

Q. Yes.—A. I do not understand they have put it in.

Mr. WICKWIRE. No; we have not offered that.

Mr. DENISON. Was not that put in as evidence in Mr. Phillip's testimony?

Mr. WICKWIRE. This bulletin has never been offered by us.

Mr. NEEDHAM. Not the bulletin, but the resolution.

Mr. DENISON. We have not offered it.

Mr. WICKWIRE. I have not offered it, either.

By Mr. DENISON :

Q. You may proceed with your statement of the history, Mr. Lutz.—A. There was a feeling in the membership of that committee, while I was still attending its meetings as a representative of a carrier, that the executive officers ought to be asked to say what they wished to say with respect to the provisions of this proposed classification. That feeling brought about, I think, the adoption of the Buffalo resolution, which submitted it to the executive officers. In the meantime, it is within my knowledge that the executive officers of some of the railroads, at least, became quite interested in the matter and instructed their accounting officers—

By Mr. WICKWIRE :

Q. (Interrupting.) You say that is within your personal knowledge. Were you present at the time these instructions were given?—



A. It is within my knowledge that at least one accounting officer received instructions from his executive officer, and it is to be assumed that under the purpose of the resolution the other accounting officers present also did. Of course, I did not see the instructions, but it was, I think, generally well understood that such instructions were in existence.

Q. Then you qualify your previous statement that it was within your knowledge as only applicable to one instance?—A. That is right.

By Mr. DENISON:

Q. In advising the commission preliminarily to its final promulgation of the rule, did you attach greater weight to the Buffalo resolutions or to the Atlantic City resolutions?—A. Greater weight was attached to the Buffalo resolutions.

Q. Why was that?

Mr. WICKWIRE. One moment, please!

It seems to me, if your honor please, that this is rather an immaterial matter as to the psychology of this witness as to what he attached great weight to and what he did not. I can not see that that has any bearing on the issues in this case which relates to the reasonableness or unreasonableness of the commission's regulations. I therefore move to strike out the last answer of the witness.

Mr. NEEDHAM. Before the court rules I want to say just a word as to the position of the commission.

It has been brought out here by the witnesses for the petitioner, by at least two witnesses—and Mr. Williams gave great emphasis to it—that the disposition of these items of account was largely a matter of business policy to be determined by the executive boards of the railroads, and not by the expert accountants. Some of the charges, he said, were not to be determined by the experts or the accountants, but as to whether they should go into capital account and increase the capital account, for reasons which the witness stated—and the other witnesses have corroborated him—was a matter of business policy, and that he would follow the directions of the executive officers.

The understanding of the commission has been right along that after the Buffalo meeting, which was made up of accountants alone they expressed their views as accountants in the adoption of the resolution at Buffalo. By the other resolutions, as we see, that resolution or program was submitted to the executive officers, and at the Atlantic City meeting the vote was, by the representatives of those railroads, a majority the other way; and it has always been understood by the commission and everyone that that change was brought about, not by a change of opinion of the experts as to the matter as an accounting proposition, but in response to the desire and the opinion and the wish of the administrative or executive officers exercising their power—and I do not say it was improper—over their representatives in saying as to this matter, "It is an executive business matter, and we want the rule to be thus and so," and they voted against it as representing the executives.

The purpose of this testimony, so far as this trial is concerned, is simply for the purpose of emphasizing the fact, which I believe to be the fact, that the Atlantic City resolution represented primarily the views of a majority of the executives, reflected and voted through their representatives on the committee.



Mr. WICKWIRE. If your honor please, in the first place, it is a fact that the action at Buffalo was simply the action of the committee of twenty-five out of an association of four hundred or five hundred members, and that, as is shown here, it was adopted very late in the meeting, at a time when many had left the meeting and apparently, according to the inference to be drawn from the witnesses' testimony, by a very narrow majority of ten to nine.

Mr. DENISON. Five was passed on early in the meeting, is the testimony here.

Mr. WICKWIRE. Maybe it was, but the testimony is very indefinite on that point. At all events, the later meeting was the opinion of the entire association, and it seems to me that—

Mr. NEEDHAM. Not the Atlantic City meeting?

Mr. WICKWIRE. I thought it was.

Mr. NEEDHAM. My understanding was that was a meeting of the committee of twenty-five. You introduced the resolution in 1910, but I am speaking now of the Atlantic City meeting.

Mr. WICKWIRE. The final position of the committee, which confirmed the position taken at the Atlantic City meeting, was unanimously opposed to the regulations of the commission.

But aside from that point, as to this matter it appears to me that it is wholly immaterial—the weight this witness attached to the deliberations of one meeting as opposed to another. How that can have any bearing upon the reasonableness or unreasonableness of the commission's regulations is not at all obvious to me.

The COURT. It may be stricken out.

Mr. DENISON. Your honor will allow me an exception?

The COURT. Yes.

By Mr. DENISON:

Q. Do you know, as a matter of fact, why the commission adopted the recommendations of the Buffalo meeting rather than the recommendations of the Atlantic City meeting?

Mr. WICKWIRE. That is objected to as immaterial, if your honor please.

The COURT. The objection is overruled.

Mr. WICKWIRE. I note an exception, your honor.

The COURT. Yes.

The WITNESS. It was because it was thought by the representatives of the commission that the resolution of the Buffalo meeting more nearly represented the ideas of the committee of twenty-five as accounting experts than did the resolution adopted at the Atlantic City meeting.

Mr. WICKWIRE. I move to strike out that answer on the ground that it is immaterial, and upon the ground also that it states a conclusion of the witness as to what the feeling of this commission was. It seems to me that is wholly incompetent evidence. I was not aware that this witness was the repository of the feelings or of the minds of the commission, and it seems to me it is highly incompetent for him to testify to what their feelings were.

The COURT. He said the representatives of the commission. I understand that to be the officers that had charge of this particular matter.

Mr. WICKWIRE. If it relates to that, then I move to strike it out as utterly immaterial.

The COURT. Oh, well, it is a little immaterial, but the motion is denied.

MR. WICKWIRE. We note an exception, your honor.

By MR. DENISON:

Q. Proceed with your statement, Mr. Lutz.—A. In connection with the action of the committee at the Atlantic City meeting, in consideration of the additions and betterments classification, it adopted the following resolution:

*Resolved*, That the findings of the committee on corporate fiscal and general accounts, in connection with the uniform balance sheet, additions and betterments, and like questions be bulletined and submitted to chief accounting officers, members of the Association of American Railway Accounting Officers, for submission to their chief executive officers, for such action as they may desire to take.

In view of the fact that this resolution provided no means by which the Interstate Commerce Commission might learn the views of the executives upon these important subjects, a letter was sent by the commission to the presidents of practically all the important railroads operating in the United States, under date of August 1, 1908. This letter directed the attention of the persons to whom sent specifically to the findings of the committee of twenty-five, and requested that if any of the gentlemen addressed had further criticisms and suggestions to make, they be submitted to the commission before October 1, 1908.

A copy of one of these letters is now filed, marked "Exhibit C. A. L. No. 10."

By MR. NEEDHAM:

Q. It was a circular letter, and the same letter was sent to every president?—A. That is true.

The circular letter referred to was thereupon marked "Exhibit C. A. L. No. 10," and is filed herewith.

RESPONDENT'S EXHIBIT C. A. L. 10.

(Page 609 of original record.)

AUGUST 1, 1908.

MR. E. P. RIPLEY,

*President Atchison, Topeka & Santa Fe Railway Co.,  
Chicago, Illinois.*

DEAR SIR: From information received it appears that at a recent meeting of the committee on corporate, fiscal, and general accounts, a standing committee of the Association of American Railway Accounting Officers, the question of the classification of additions and betterments being under consideration, the following resolution was adopted:

*"Resolved*, That the findings of the committee on corporate, fiscal, and general accounts in connection with the uniform balance sheet, additions and betterments, and like questions be bulletined and submitted to chief accounting officer, members of the Association of American Railway Accounting Officers for submission to their chief executive officers for such action as they may desire to take."

From the wording of this resolution it will be observed that no provision is made by which the Interstate Commerce Commission can learn the views of the executives upon these most important subjects. Heretofore in all matters of accounts the commission, in its desire to work in harmony with the official representatives of the carriers, has refrained from deciding any important question until the views of the accounting officers of the association respecting it had been submitted in the form of definite recommendations and the commission still desires the cooperation and assistance of carriers in the further

development of a standard system of accounts. It can not, however, carry this desire for cooperation so far as to result in unnecessary delay in the constructive work undertaken. As bearing upon the particular question under consideration by the accounting officers at the time the above resolution was passed, namely, the classification of additions and betterments, it may be appropriate to call attention to the fact that twice before has this classification been submitted for the advice and criticisms of executives: once by the resolution of the committee on corporate, fiscal, and general accounts and once by the issue of accounting series circular No. 23. A considerable number of replies were received from prominent executive officers throughout the country and the commission had assumed, until information of the resolution quoted above was received, that it was now in possession of the permanent views of executive officers with regard to this question. It appears, however, from this resolution that yet a third opportunity for criticisms and suggestions by executive officers is thought desirable.

In view of the above statement and as a further expression of the desire of the commission to receive and consider whatever expressions of opinion the representatives of the carriers may care to submit relative to all general questions of accounts, while at the same time recognizing that definite and final action should be taken upon this particular question at the earliest possible date, the following announcement is made:

Whatever criticisms upon the tentative classification of additions and betterments or suggestions for its modifications the executives desire to submit must be filed in the Division of Statistics and Accounts before October 1, 1908.

Very respectfully,

(Signed) HENRY C. ADAMS,  
*In Charge of Statistics and Accounts.*

Approved for the commission,

(Signed) JAMES S. HARLAN, *Commissioner.*

The Court. We will take a recess at this time until 2 o'clock this afternoon.

Thereupon at 12:30 o'clock p. m. a recess was taken until 2 o'clock p. m.

#### AFTER RECESS.

The hearing was resumed at two o'clock p. m.

CHARLES A. LUTZ, the witness on the stand at the time of the taking of recess, resumed the stand and testified further, as follows:

By Mr. DENISON:

Q. Was the vote on the question here involved unanimous at the Atlantic City meeting, Mr. Lutz?—A. No.

Q. There were members of the committee who voted in favor of the point of view which was represented by the Buffalo report and by the commission's ultimate orders?—A. There were.

Q. Do you remember whether there was a large preponderance one way or the other, or was it a close vote?—A. It was rather a close vote.

Q. You may proceed now with your statement.—A. I had just filed, I think, a copy of one of the letters written by the commission to the executive officers of carriers as my exhibit C. A. L. No. 10.

The responses to this letter were given careful consideration in the Bureau of Statistics and Accounts of the commission, and on April 14, 1909, Mr. Adams addressed a letter to the chairman of the committee of twenty-five, one of the subjects in which was the proposed classification of additions and betterments. This letter and the accompanying exhibits were printed by the association as bulletin 36-C, a copy of which I file marked "Exhibit C. A. L. No. 11."

The paper referred to was received in evidence, marked "C. A. L. Exhibit No. 11," and is filed herewith.

MR. WICKWIRE. Do I understand that this is offered in evidence?  
MR. DENISON. Yes.

MR. WICKWIRE. For the purpose of abbreviating the record, would like to ask whether you desire to offer a particular portion of it or all of it?

MR. DENISON. We will restrict the offer to the first four pages.

RESPONDENT'S EXHIBIT C. A. L. NO. 11.

(Printed in part.)

Bulletin No. 24-C

Standing committee on corporate, fiscal, and general accounts: A. H. Plant, chairman; C. G. Phillips, secretary; M. P. Blauvelt, S. B. Schuyler, C. I. Sturgis, N. J. Power, R. A. White, W. E. Bailey, R. I. Farrington, C. F. Krebs, G. N. Wilson, Erastus Young, H. A. Gray, W. J. Hobbs, S. C. Johnson, M. M. Kirkman, M. Riebenack, H. D. Bulkley, P. A. Hewitt, A. H. Plant, J. W. Renner, J. L. Cramer, Carlton Hillyer, S. M. Hudson, J. A. Taylor, T. J. Tobin, W. H. Williams.

ASSOCIATION OF AMERICAN RAILWAY ACCOUNTING OFFICERS.

OFFICE OF THE CHAIRMAN.

Washington, D. C., April 19, 1909.

To members of the Standing Committee on Corporate, Fiscal, and General Accounts:

GENTLEMEN: I have just received from Mr. Adams his letter of April 10th enclosing certain typewritten sheets in regard to additions and betterments on the balance sheet prepared by him. I understand a similar communication has been addressed to each member of the committee, enclosing them copies of the documents referred to therein. I deem it best, however, to bulletin these documents and to present them to the committee in advance of the meeting of the Association.

While I do not consider it necessary to call a meeting of the committee, consider this matter in advance of the association meeting, I feel it would be advantage to both the committee and the association if an informal discussion could be had of these matters in advance of the meeting, and I trust it will be possible for such a conference to be held during the first day of the association meeting.

Respectfully,

A. H. PLANT,  
Chairman

INTERSTATE COMMERCE COMMISSION

BUREAU OF STATISTICS AND ACCOUNTS.

Washington, D. C., April 14, 1909.

MR. H. A. PLANT,

Comptroller Southern Railway Company, Washington, D. C.

DEAR SIR: Since the meeting of the committee on corporate, fiscal, and general accounts, recently held at Buffalo, I have again gone over the whole of the additions and betterments classification and the balance sheet with its accompanying text. Thinking that you might be interested in the result of this final study, I send you the accompanying documents.

Exhibit A. This exhibit contains, first, a revision of the general instructions which it is proposed should precede the classification of additions and betterments; and, second, a statement of the principles which have been followed in working out the details of that classification. I think you may learn from these concise statements, quite as well as from the text, the present condition of the classification of additions and betterments.

Exhibit B. This exhibit covers in detail all the changes which have been made in the balance sheet approved by the committee on corporate, fiscal, and general accounts at Buffalo, and the reasons therefor. Some of these changes are matters of taste; others are rearrangements which on the whole seem

satisfy a large number of balance-sheet requirements, and some are required by certain general principles which seem essential to the commission.

Exhibit C. This exhibit is the modified balance sheet with the accompanying text. I feel that I should apologize for sending carbon copies. My chief reason for not having this matter printed for distribution is the danger that, in the hands of others than members of the committee of twenty-five, it might be regarded as the final and authoritative word upon this set of accounts.

I have ventured to place this in your hands prior to the meeting of your association for such use as may seem wise to you under the circumstances.

Very truly, yours,

HENRY C. ADAMS,

*In Charge of Statistics and Accounts.*

Enclosures.

#### EXHIBIT A.—ADDITIONS AND BETTERMENTS.

1. *General instructions.*—Additions and betterments include additional structures, facilities, or equipment not taking the place of anything previously existing, and the enlargement or improvement of existing structures, facilities, or equipment, or the proper portion of the cost of new structures, facilities, or equipment of an improved or higher class taking the place of others previously existing.

Expenditures for additions and betterments should, at the end of the fiscal year, be reclassified in accordance with the primary accounts as provided for in the classification of expenditures for road and equipment, it being understood that all expenditures for additions and betterments shall be charged to road and equipment.

Expenditures for additions and betterments amounting to less than \$200.00, except as herein further provided, should be charged to the appropriate operating expenses or outside operations account.

In case it becomes necessary directly in the course of betterment and improvement work to abandon large and important pieces of property, the original cost, estimated if not known, of the property so abandoned should be credited against a corresponding proportion of the cost of the improvement and should be charged, less salvage, to an account called "Property abandoned," to which should also be charged the cost of removing the material and any other incidental expenses incurred in connection with its abandonment, in accordance with the text of the account "Property abandoned" in the classification of balance-sheet accounts.

This classification applies exclusively to additions to, or betterments of, existing operating lines and the equipment thereof.

#### CLASSIFICATION OF ADDITIONS AND BETTERMENTS EXPENDITURES.

1. Right of way and station grounds.
2. Real estate.
3. Widening cuts and fills.
4. Protection of banks.
5. Grade revisions and changes of line.
6. Tunnel improvements.
7. Bridges, trestles, and culverts.
8. Increased weight of rail.
9. Ballast.
10. Additional main tracks.
11. Sidings and spur tracks.
12. Terminal yards.
13. Fencing right of way.
14. Improvement of over and under grade crossings.
15. Track elevation, elimination of grade crossings, etc.
16. Interlocking apparatus.
17. Block and other signal apparatus.
18. Telegraph and telephone lines.
19. Station buildings and fixtures.
20. Shops, engine houses, and turntables.
21. Shop machinery and tools.
22. Water and fuel stations.
23. Grain elevators and storage warehouses.

24. Dock and wharf property.
25. Electric light and power plants.
26. Electric power transmission.
27. Gas-producing plants.
28. Snow and sand fences and snow sheds.
29. Miscellaneous structures.
30. Reconstruction of road purchased.
31. Equipment.
32. Interest and commission.

2. *Explanation of additions and betterments.*—An explanation of the classification of additions and betterments which it is proposed to adopt may be satisfactorily made by calling attention to the differences between this classification and the previous classification issued as accounting series circular No. 11. The changes are as follows:

First. The distinction between additions and betterments has been eliminated.

Second. Accounting series circular No. 11 provided that when an abandonment of property took place, whether such property was replaced by new and improved property or not, the cost of the property abandoned should be credited to additions and betterments and charged to operating expenses. The present classification retains this provision only in the case of property of minor importance or of minor value. When improved or costly pieces of property are abandoned in course of extensive betterment work, the cost of such property is to be credited against a corresponding proportion of the cost of the improvement and is to be charged to an account entitled "Property abandoned," which has been introduced in the balance sheet, with the intention that the cost of such property shall be redistributed to operating expenses over a period of from three to ten years. When such property is abandoned and not replaced, however, the additions and betterments accounts are not affected, for the reason that the classification of balance-sheet accounts provides that the cost of such property shall be deducted directly from the account to which it was originally charged.

Third. Credits to accounts for old material removed or property abandoned have been introduced systematically on an original cost basis, the cost to be estimated if not known. This will be the occasion of several minor differences between the text of this classification and the text of accounting series circular No. 11. The changes are necessary in order that the property accounts may contain only the cost of property in the carrier's possession, a principle which has been kept in mind in compiling all the classifications which affect the property accounts.

Fourth. The several accounts for the various classes of equipment have been eliminated and one account substituted in their place. This, however, does not relieve carriers from the necessity of redistributing these accounts at the end of the fiscal year in accordance with the detailed equipment accounts contained in the classification of expenditures for road and equipment.

Fifth. While not affecting directly the classification of additions and betterments expenditures, it may be stated, in this connection, that inasmuch as the balance sheet provides that all additions and betterments are to be charged to the proper accounts under the caption "Property owned as investment," it will no longer be permissible to charge such improvements to income, profit and loss, or special funds created from income or surplus.

Sixth. The \$200,000 minimum for which provision was made in accounting series circular No. 11 is retained on the ground that to this extent addition and betterments may be charged directly to operating expenses as an offset to depreciation on property that can by no means be covered by formal depreciation charges. This is accepted as being in harmony with conservative management.

18. **PROPERTY ABANDONED, CHARGEABLE TO OPERATING EXPENSES.**—There shall be carried on the carrier's general ledger an account entitled "Property abandoned."

Under this caption should be included:

(a) *Property abandoned through additions and betterments.*—The original cost (estimated, if not known), less salvage, of important pieces of property, such as main line and sidings appurtenant thereto, including right of way and track material; station buildings and grounds; engine houses, turntables, and shop buildings, and grounds thereof; terminal yards, including tracks, right of way, buildings and other structures therein; old rails removed from track in the course of executing a general plan of relaying track with rail of heavier weight; bridges and trestles abandoned by reason of replacing them with

bridges and trestles of greater capacity or more permanent nature; interlocking apparatus abandoned in course of elimination of grade crossings or other improvements; block and other signal apparatus replaced with apparatus of a different and improved type; fuel stations, grain elevators, storage warehouses, dock and wharf property, electric light and power plants and electric-power transmission systems, gas-producing plants, and all other important miscellaneous structures abandoned in course of replacing them with enlarged or improved property, including the cost of removing old material and all other incidental expenses directly in connection with the abandonment thereof.

NOTE A. The cost of the above property should be credited to appropriate accounts under "Additions and betterments."

NOTE B. Charges to this account on account of property abandoned through additions and betterments should be redistributed to the carrier's operating expenses or outside operation accounts in equal annual instalments during a period of not less than three years nor more than ten years from and including the year in which the property is abandoned. Carriers may, however, commence such charges in the year following the abandonment. The balance remaining in this section of the "property abandoned" account at the close of the fiscal year appears on the balance sheet under the caption "Property abandoned chargeable to operating expenses."

(c) *Property abandoned and not replaced.* The original cost (estimated, if not known), less salvage, of important pieces of property, such as those described in the preceding paragraph, which have been abandoned, but not in connection with improvements or betterments, including the cost of removing old material and all other incidental expenses directly in connection with the abandonment thereof.

NOTE A. The cost of the above property should be credited to the accounts to which it was originally charged.

NOTE B. Charges to this account on account of property abandoned not in connection with improvements or betterments should be redistributed to profit and loss at the end of the fiscal year.

The WITNESS. Further consideration having been given the subject by the committee of twenty-five, it was bulletined by the association as Bulletin No. 36-D, a copy of which is filed, marked "C. A. L. Exhibit No. 12."

The paper referred to was received in evidence, marked "C. A. L. Exhibit No. 12," and is filed herewith.

Mr. WICKWIRE. Just a moment, please.

The WITNESS. In this bulletin the committee's Atlantic City report on additions and betterments, and the tentative classification issued by the commission in accounting series circular No. 11, are shown side by side.

Mr. WICKWIRE. Do you want to offer it all?

Mr. DENISON. I think we shall have to offer the whole of that exhibit. It shows that the Atlantic City meeting retained a similar principle in reference to abandoned property for other classes of the accounts to that which is in issue here.

Mr. WICKWIRE. Are there not numerous portions of this bulletin relative to other matters, which are immaterial and may be omitted in the offer?

Mr. DENISON. We can restrict it to page 1, and pages 23 to 51, inclusive.

RESPONDENT'S EXHIBIT C. A. L. No. 12.

[Page 1. Pages 23 to 51 not printed.]

Bulletin No. 36-D

Standing committee on corporate, fiscal, and general accounts: A. H. Plant, chairman; C. G. Phillips, secretary; W. E. Bailey, R. I. Farrington, C. E. Krebs,



G. N. Wilson, Erastus Young, H. A. Gray, W. J. Hobbs, S. C. Johnson, M. M. Kirkman, M. Riebenack, H. D. Bulkley, P. A. Hewitt, A. H. Plant, J. W. Renner, J. L. Cramer, Carlton Hillyer, S. M. Hudson, J. A. Taylor, T. J. Tobin, W. H. Williams, Frank Noy, C. B. Hayes, Jos. W. Coxe, M. F. Molloy, L. G. Scott.

ASSOCIATION OF AMERICAN RAILWAY ACCOUNTING OFFICERS,

OFFICE OF THE CHAIRMAN,

Washington, D. C., May 25, 1909.

*To members of the Standing Committee on Corporate, Fiscal, and General Accounts.*

GENTLEMEN: As advised in my letter of the 8th instant, based on communications I have received and conferences I have had in respect to the balance sheet and the classification of additions and betterments, I feel it necessary to call the committee together for another meeting, which is formally called for Hotel Astor, New York City, Monday, May 31st, 10:30 a. m.

The principal matters for consideration by the committee are:

1. The balance sheet and text therefor.
2. Classification of additions and betterments and text therefor.
3. Sundry queries, answers, and topics previously submitted to the committee, but upon which no action has yet been taken.

For convenience of the committee in its deliberations at this meeting, I have bulletined and herewith submit in parallel columns the balance sheet and text therefor prepared by the committee at its Louisville and Buffalo meetings, and the suggestions prepared by Mr. Adams and submitted to the members of the committee in his letter of April 14th last. I have likewise treated in parallel columns the classification of additions and betterments as prepared by the committee at its Atlantic City meeting and as submitted by Mr. Adams in his accounting series circular No. 11. I have endeavored to make references from those two documents to the explanation of changes made by Mr. Adams in them, referred to in his letter of April 14th, and embodied in bulletin No. 36-C. I have felt it best to produce these documents in this shape not only for ready reference, but that the committee may have full benefit of all possible light on them.

Acting upon the authority given by the committee at its meeting on the 28th ultimo, as follows:

"The chairman was authorized to reply to an inquiry of Mr. F. A. Delano, president of the American Railway Association, that this committee was ready to further consider the balance sheet if brought before it either by the executives or by a properly accredited committee of the American Railway Association."

I have sent the following letter to Mr. F. A. Delano, president of the American Railway Association, in respect to joining the committee in its deliberations upon the balance sheet and the classification of additions and betterments:

WASHINGTON, D. C., May 18, 1909.

MR. F. A. DELANO,

*President of the American Railway Association,*

*25 Park Place, New York, N. Y.*

MY DEAR MR. DELANO: Further, in connection with your letter to me of the 27th ultimo and my reply of the 30th in regard to consideration of a balance sheet in connection with the requirements of the Interstate Commerce Commission:

I note in your letter the following query: "Does your committee care to consider the various suggestions already made or urge that the final action of the commission be deferred until the American Railway Association have had an opportunity to consider it?"

You will recall that in addition to the balance sheet question, the proposed classification of additions and betterments also needs consideration, and I infer from your letter that the suggestion made by some of the executives that the American Railway Association handle the balance sheet for them carries with it also the consideration of the classification of additions and betterments.

Understanding that the American Railway Association is to represent certain interests in the consideration of these two questions and that certain other interests have placed the matter in the hands of their chief accounting officers to be handled through the committee on corporate, fiscal, and general accounts, and also that still other interests prefer to deal direct with the Interstate Commerce Commission in respect to these questions, it has occurred to me that it



would be well if a joint conference could be had between your committee, the committee on corporate, fiscal, and general accounts, and the representative of the Interstate Commerce Commission for the purpose of harmonizing as far as possible all interests in these matters, with a view of reaching practicable and harmonious conclusions.

A meeting of the committee on corporate, fiscal, and general accounts has been called at the Hotel Astor, New York, 10.30 a. m. on Monday, May 31st, for the purpose of further considering these two questions. I am sure the committee will be very glad to have the benefit of the presence of your committee during its deliberations and to receive from it such suggestions as it may have to make in regard to these matters. If your committee can not be present, we will be only too glad to have from you the various suggestions received by you, reference to which is made in your letter of the 27th ultimo.

Yours, very truly,

(Signed) A. H. PLANT, *Chairman*.

As I view the situation in respect to these two important matters, there is some confusion as to how they should be dealt with by the various railways interested. There appear to be three interests involved:

1. Represented by the accounting committee, the members of which are acting under instructions from their executives;

2. Certain executives represented by the special committee of the American Railway Association; and

3. Still other executives who, it would appear, prefer to deal directly with the commission in respect to these matters.

My view, which is respectfully submitted to the committee, is that an effort should be made to harmonize as far as possible these three interests, to the end that uniform and harmonious results may be obtained and that practical conclusions can be reached with the representatives of the commission upon these important matters. With that end in view, it is earnestly requested that each member endeavor to come to the meeting prepared to act authoritatively for his line.

The resolution passed by the association at its Cincinnati meeting directing the distribution of bulletins issued by the committee is not clear to me as to whether it was intended that bulletins similar to this one should be so distributed. However, in order to meet the wishes of the association, I am sending copies of this bulletin to chief accounting officers of all lines, members of the association, to the end that the wishes of the association may be complied with, and also that all such chief accounting officers may be fully advised as to matters before the committee for its action.

All of which is respectfully submitted.

A. H. PLANT, *Chairman*.

The WITNESS (continuing). The matter having been discussed at a meeting held in New York City on May 31, 1909—

By Mr. DENISON:

Q. What was that meeting?—A. A meeting of the committee of twenty-five.

The WITNESS (continuing). Was taken up actively in the Bureau of Statistics and Accounts of the commission, and the classification as made effective under order on July 1, 1909, known as "classification of expenditures for additions and betterments as prescribed by the Interstate Commerce Commission for steam roads, first issue," was promulgated. I understand a copy of this classification is in the record as an exhibit to the answer of the Interstate Commerce Commission. Subsequently—

Mr. NEEDHAM. With reference to those exhibits, I have spoken to counsel, and it is understood that those may be referred to, or parts of them, by the counsel, and that they are offered in evidence for that purpose. They are attached to the commission's answer, or filed with it rather

The COURT. Very well.

Mr. NEEDHAM. That is understood.

Mr. WICKWIRE. That is satisfactory.

Mr. NEEDHAM. Yes.

The WITNESS (continuing). Subsequently, and during the year ended June 30, 1910, the committee of twenty-five gave further consideration to the matters involved and recommended to the association certain resolutions as embodied in the seventh subject of its report to the twenty-second (1910) annual meeting. The recommendations under the seventh subject which were adopted by the association at its meeting in Colorado Springs, Colorado, on June 29th and 30th, and July 1st, 1910, read as follows.

Is that report in the record?

Mr. NEEDHAM. I thought Mr. Phillips put that in.

The WITNESS. This resolution seems to be embodied in one of the exhibits filed by Mr. Phillips. So I take it I need not introduce it.

Consideration having been given to the subjects contained in this resolution in the light of the criticisms received from all interested parties during the year ending June 30, 1910, in which the first issue of the classification of additions and betterments was effective, such criticisms arising from the actual experience of carriers working under the effective classification, the Bureau of Statistics and Accounts decided to recommend to the commission and the commission adopted the first revised issue of the classification of additions and betterments, effective July 1, 1910. This revised classification, as I stated, being based upon the experience of the carriers for practically a year under the previous classification, took care of a number of the points of difficulty referred to in the approved resolution of the committee of twenty-five which I have just quoted, and corrected as well a number of other points in which no change of principle was involved but which in the first issue had not been so clearly expressed as was desirable.

By Mr. DENISON:

Q. Mr. Lutz, did those revisions, those changes, concern the matter involved here with reference to these six pieces of relocation?—

A. One of the changes does, at least.

It was felt by the committee that to charge out of the property account the cost to replace in kind property abandoned, which was not included in the property account at its full reproduction cost, or at a substantial sum less, we will say, than its full reproduction cost would tend at some times to overcharge operating expense, even taking the view of operating expense which was held by the commission. As an illustration, the committee suggested that, assuming the carrier had a line of railroad which it had purchased, we will say, at ten thousand dollars a mile, and, subsequently, before adoption of the commission's rule which precluded that, had improved that property by charges to operating expenses to the extent, say, of fifteen thousand dollars a mile, so that the reproduction cost of that property would be approximately twenty-five thousand dollars a mile, to take out of the property account twenty-five thousand dollars a mile when only ten thousand dollars a mile stood in the property account

with respect to that property, was objected to. We met that objection by the provision in paragraph 12, page 17, of the classification of expenditures for additions and betterments, first revised issue, which reads as follows:

*Treatment of abandoned property when cost is understated.* In case a specific piece of property, abandoned subsequently to June 30, 1907, had been, previously to that date, so improved through charges to income, profit and loss, or operating expenses, that the book value or record value is much less than the actual cost of the property, a carrier may, upon filing with the Interstate Commerce Commission a full description of the property and of the proposed improvements which require its abandonment and a comprehensive statement explanatory of the conditions which justify such treatment, and upon receiving the approval of the commission, accept such book value as a basis for computing the amount to be charged to operating expenses with respect to the property abandoned. The amount to be charged to operating expenses under such conditions should be the same proportion of the cost of replacing the property in kind as the book value is of the total actual cost.

Q. Excepting for that change, was the revised classification the same as the former one, in so far as concerns the portion of the account involved here; I mean substantially?—A. I think there is one other substantial point, Mr. Denison—no; I guess the point I had in mind was covered in both issues, that was the privilege of setting up in advance of abandonment depreciation accounts to take care of future abandonments.

Q. There was no change in the fundamental principles, at any rate?—A. There was not.

The foregoing, I think, gives a fairly complete history of the successive steps in the development of that portion of the uniform system of accounts which has to do with the requirements of the classification of operating expenses concerning depreciation charges and of the classification of additions and betterments concerning the treatment of abandoned property in the accounts of carriers subject to the act.

I desire to mention some of the considerations held in mind by the Bureau of Statistics and Accounts in the formulation of the rules provided in the classification of additions and betterments and in the form of general balance sheet statement as finally issued under order of the commission. It was believed—

Mr. WICKWIRE. One moment. Are those not matters of argument rather than to go into the views on various matters of the representatives of the commission?

The COURT. As the chief of that bureau of the Interstate Commerce Commission, he was asked to state what reasons influenced that bureau or himself in the establishment of this rule.

Mr. WICKWIRE. Mr. Adams was then the chief officer, was he not, in charge of the accounts?

The WITNESS. Mr. Adams was in charge of the two divisions of Statistics and Accounts. I was the chief of the Division of Carriers' Accounts, reporting to him.

Mr. WICKWIRE. Yes.

The WITNESS. Until he left the service of the commission, I think about June, 1911, since which time I have been in charge of the same division, reporting directly to the commission.

Mr. WICKWIRE. Yes.

The WITNESS. In any considerations of these matters in the Bureau of Statistics and Accounts, before the recommendations were made to the commission, I, as chief of that division, participated in the conferences with Mr. Adams and other employees of the commission.

Mr. WICKWIRE. The witness has not yet stated it strictly that these were his views, or what his views were. Now, if he does that and then wishes to explain his views, it seems to me this might be pertinent, but at this stage I do not think it is material.

The COURT. You put a witness upon the stand and you ask him a hypothetical question involving the facts of this case, and ask him where he would place this charge or credit, and he says in a certain account. Then you ask him to give his reasons why he does so. Now, here is the commission's rule, a rule adopted by the commission, upon the advice of the bureau and the chief of that bureau, or a man occupying a prominent position in it is here, and he would have a right to give the reasons why they advised the adoption of this rule, the same as your witnesses have the right to explain the reason why they say they would put a certain charge in a certain account.

Mr. WICKWIRE. If I may ask a question, perhaps it will clear the matter up.

By Mr. WICKWIRE:

Q. Am I to understand that these classifications as promulgated by the commission at different times represented your views, and that you coincided with the wisdom of those as representing correct principles of accounting?—A. Generally speaking, yes. There are points, perhaps unimportant points, in which I do not fully coincide personally with the recommendations which were finally made to the commission, but as to this particular point, they represent my views.

By Mr. DENISON:

Q. As to the point in controversy?—A. As to the point in controversy.

Mr. WICKWIRE. Well, if it is in explanation of what he states as his general position on the principles involved, I have no objection to it.

The COURT. I understand that is what he is talking about.

A. (Continuing.) It was believed to be generally recognized that correct accounting principles require charges to operating expenses not only for the cost of rendering the transportation service and the cost of current repairs to the property, but also as well for the value lost through depreciation of the property on account of use, obsolescence and inadequacy.

By Mr. WICKWIRE:

Q. You say it was believed. Do you mean by that that you believed that?—A. I believed it. It was believed that a system of accounts which failed to recognize these principles would fail properly to provide for adequate charges to operating expenses for the maintenance of the property used in operation. It was also believed that the inclusion in operating expenses of the cost of new and additional

property or of improvements and betterments to previously existing property would result in an overstatement of the cost of earning the revenues of the carrier. It was believed, further, that the recommendations of the committee of twenty-five, as embodied in the association's bulletin No. 28, followed more closely the correct accounting principles in this respect than did the committee's subsequent recommendation at the Atlantic City meeting, when the actions of a considerable number of the members of the committee were influenced by the directions of the executives of their respective companies. The question of a correct statement of property accounts is one of primary importance in a uniform system of accounts. It was determined to recommend to the commission a classification drawn upon such a basis as that the asset account for property used in operation should show the cost of, or the investment of the carrier in, only such property as an appraiser who might be called upon to value the property of the carrier would find in making a physical examination. It was recognized that with respect to the accounts for property acquired prior to the adoption of the commission's classification, the classification could not require a restatement thereof, but it was drawn upon such a basis as enables the realization of this theory in the accounts of carriers organized thenceforth or for additional lines built thereafter. This principle of the statement of cost or investment could be realized only, in my opinion, by providing that all new lines constructed or acquired, and all additions and betterments to existing lines, be included in the property accounts on the one hand and on the other hand that all property discontinued in use or abandoned should be credited to the property accounts. In strict theory, charges to operating expenses for abandoned property, in order to show correct statements of net operating revenues, should be made during the period in which the property was used prior to its abandonment. The rule of the commission with respect to the abandonment of rolling-stock equipment is in harmony with this theory, as it requires charges to operating expenses for depreciation to be made during the life of such equipment. On account, as I said before, of the extreme difficulty of arriving at proper estimates of depreciation on other classes of property, the rules do not require the setting up of reserves by charges to expenses in advance of the abandonment of such other property such as roadway, ties, rails, bridges, buildings, and the like. The carriers, however, are permitted, on application to the commission, to set up such operating reserves for abandonment, to which reserves the value of such abandoned property may be charged.

With respect to property other than land or equipment which is abandoned and *not replaced*, there are two methods by which a carrier may provide for charging out of the property account the value of such property. It may apply to the commission and receive permission to set up depreciation accounts in operating expenses for the purpose of creating a reserve to which the cost of such abandoned property may be charged, or it may make no anticipatory provision of this kind, and when the property is abandoned may credit the entire cost to the property accounts, which amount, less salvage, may be charged to profit and loss account. The foregoing provision, it should

be borne in mind, applies only to the abandonment of property which is not replaced by any other property to be used for the same general purpose as was the property abandoned.

For the cost of property which is abandoned directly in connection with additions and betterments work, or, to express it in another way, property that is replaced by other property devoted to the same general purpose or use, the rule of the commission provides that the cost of replacing in kind the property retired shall be included in operating expenses, but provides three methods by which expenses may be charged for such abandonments:

1. The carrier may set up a reserve for abandonment through charges to operating expenses with respect to important pieces of property to be abandoned, under the provisions of paragraph eight in the general instructions on page 16 of the classification for additions and betterments, first revised issue.

2. It may charge directly to operating expenses at the time of abandonment the cost of replacing in kind such abandoned property, in accordance with the provisions of the text and notes under the various primary accounts in the classification of additions and betterments.

3. In case the amount chargeable to operating expenses for property abandoned directly in connection with improvements is relatively large, and the inclusion in a carrier's operating expenses for a single year would unduly burden its accounts for that year, the carrier may apply to, and receive permission from, the commission to use an account known as "property abandoned chargeable to operating expenses," and thereafter may apportion such charges to the operating expenses of succeeding years, the number of which will be determined when permission to use the account is given. This privilege is provided for in rule 9 on page 16 of the classification of expenditures for additions and betterments.

The effect of these three provisions is to allow considerable latitude and a carrier may avail itself of whichever option its operating and financial conditions, in the judgment of its officers, render preferable.

By MR. DENISON:

Q. At that point, Mr. Lutz, has this petitioner made any application to the commission to have the charge spread over a number of years?—A. It has not.

The latitude granted by options Nos. 2 and 3 which I have just outlined is perhaps a departure from a most approved accounting principle, and from strict uniformity of practice in recognition of the practical difficulties in the observance of the more approved accounting theory.

With respect to the propriety of charges to operating expenses for the cost to replace in kind property abandoned, it is worthy of note that the same principles originally embodied in the text of additions and betterments account No. 5—Grade revisions and changes of line, as shown in the first action of the committee of twenty-five in its bulletin No. 28, were retained by the committee under account No. 7—Bridges, trestles and culverts; account No. 8—Increased weight of

rail; account No. 16—Interlocking apparatus; account No. 17—Block and other signal apparatus; account No. 18—Telegraph and telephone lines; account No. 19—Station buildings and fixtures; account No. 20—Shops, engine houses and turntables; account No. 21—Shop machinery and tools; and perhaps others. The account numbers referred to are those used in the association's bulletin No. 33, my exhibit C. A. L. No. 9, in its report of the Atlantic City meeting of the committee of twenty-five.

Bulletin 33, above referred to, was marked "Exhibit C. A. L. No. 2," and is filed herewith by agreement of counsel. See stipulation.

RESPONDENT'S EXHIBIT C. A. L. No. 9.

[Printed in part.]

Bulletin No. 33.

Standing committee on corporate, fiscal, and general accounts: A. H. Plant, Chairman; M. P. Blauvelt, S. B. Schuyler, C. I. Sturgis, N. J. Power, R. A. White, W. E. Bailey, R. I. Farrington, C. F. Krebs, G. N. Wilson, Erastus Young, H. A. Gray, W. J. Hobbs, S. C. Johnson, M. M. Kirkman, M. Riebenack, H. D. Bulkley, P. A. Hewitt, A. H. Plant, J. W. Renner, J. L. Cramer, Carlton Hillyer, S. M. Hudson, J. A. Taylor, T. J. Tobin, W. H. Williams.

ASSOCIATION OF AMERICAN RAILWAY ACCOUNTING OFFICERS.

OFFICE OF THE CHAIRMAN.

Washington, D. C., July 15, 1908.

*To chief accounting officers, Members of the Association  
of American Railway Accounting Officers.*

GENTLEMEN: At a meeting of the standing committee on corporate, fiscal, and general accounts held at Atlantic City, on July 6th, 7th, 8th, and 9th, 1908, the following tentative classification of additions and betterments expenditures was formulated by that committee and is hereby submitted to members in accordance with the following resolution adopted by the committee:

*Resolved, That the findings of the committee on corporate, fiscal, and general accounts in connection with the uniform balance sheet, additions, and betterments, and like questions be bulletined and submitted to chief accounting officers, members of the Association of American Railway Accounting Officers, for submission to their chief executive officers, for such action as they may desire to take.*

It is therefore requested that members submit this tentative classification to their executive officers in accordance with the resolution quoted.

Should it be your desire or the desire of your executives to transmit through the chairman any communications to the committee on corporate, fiscal, and general accounts in respect to these matters, it will be my pleasure to receive them and to transmit them to the committee.

Respectfully,

A. H. PLANT, *Chairman*.

5. GRADE REVISIONS AND CHANGES OF LINE.

To this account should be charged:

GRADE REVISIONS.—Cost of reducing grades by cutting down summits and raising sags without materially changing the alignment. The amount to be charged to this account for work of this nature is the cost of the additional grading done, including as a portion of such cost expenses of operating steam shovels and work trains, building temporary tracks for steam shovels, and grading outfits, tools used in the work, etc.; raising or lowering existing bridges, increasing length of culverts on account of increasing width of embankments, and replacing riprap at culvert ends; moving and relocating telegraph or telephone poles and lines, block and other signal systems, fences,

buildings, etc.; changing grade crossings for farms, country roads or highways, and streets, including crossing gates, highway crossing alarms, and watch houses.

*NOTE.*—The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade should be charged to appropriate operating expense accounts.

**CHANGES OF ALIGNMENT.**—Cost of changing alignment for purposes of reducing curvature, cutting out bridges, tunnels, etc.

**CHANGES OF LINE.**—Cost of building new lines, exclusive of cost of right of way therefor, which should be charged to account "Right of way and station grounds;" for the purpose of improving both grade and alignment. It includes the cost of engineering; clearing and grubbing; grading; tunnels; bridges, trestles, and culverts; ties, rails, frogs, and switches, track fastenings, and other track material; ballast, tracklaying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines, also cost of tools and expenses of steam shovels, and other work equipment, engines, cars, and crews employed in the work.

*NOTE.*—Cost of buildings, water, and fuel stations and similar structures on new lines, should not be charged to this account, which is intended to cover the roadway and track only.

#### 20. SHOPS, ENGINE HOUSES, AND TURNABLES.

To this account should be charged the cost of all additional buildings constructed to be used as shops or car sheds (including transfer tables in connection therewith); engine houses (including turntables, chlder and drop pits in connection therewith); plants for furnishing power or for heating and lighting such additional buildings; platforms, sidewalks, and outhouses in connection with additional buildings; additional oil houses, sand houses, storehouses for company's material, scrap bins, appurtenances, etc.; also chlder pits, drop pits outside of engine houses, and turntables where none before. This account should include amounts paid when erected by contract, labor and material when built by company; preparing grounds before and clearing same up after construction; foundations and painting; excavation for and filling of additional turntable pits, and of chlder or drop pits inside or outside of additional engine houses; foundation for additional turntables; loading, unloading, and placing turn-bles in position; levers, trusses, and stops for handling turntables; sewerage systems, connection with water supply system, and shop wells for additional buildings; architect's fees for drawing plans for and supervision of construction of additional buildings; cost of fences and hedges on and around additional shop grounds or around additional buildings; incidental expenses, and cost of all tracks laid in any additional building above described, on transfer and turntables in connection with such additional buildings and leading from such transfer or turn-bles into additional shops and engine houses.

To it should also be charged the excess cost of new buildings to be used as shops, car sheds, and engine houses, and of new transfer tables, turntables, chlder and drop pits in connection therewith, over the cost of replacing the existing structures; the cost of plants for furnishing power or for heating and lighting existing shop buildings, engine houses, etc., when such plants not now existing, and the excess cost of new plants of that character over cost of replacing existing plants; cost of construction where not existing or excess cost of replacing existing platforms, sidewalks, and outhouses in connection with existing shop buildings or engine houses; excess cost of enlarging, altering, or rebuilding oil houses, sand houses, storehouses for company's materials, scrap bins, appurtenances, etc., over cost of replacing existing structures; drop pits inside existing engine houses where no pits previously; trusses or other apparatus for handling existing turntables, enlarging and deepening shop wells; excess cost of reconstructing water supply and sewerage systems for shops and engine houses over cost of replacing the existing; cost of fences and hedges on or around existing shop grounds or buildings where not previously fenced; all expenses incident to paving and draining existing shop grounds or grounds



around existing shop buildings, engine houses, etc.; and excess cost of extending, rearranging, or relaying tracks in shop buildings or engine houses, on transfer or turntables in connection therewith, or of tracks leading from such transfer or turntables into shop buildings or engine houses over the cost of replacing the existing tracks.

The WITNESS (continuing). It was therefore in the judgment of the representatives of the commission necessary to a harmonious application of the principle that property accounts should include only the cost of the property used in operations, and that operating expenses should include the full cost of maintaining the property, which embraces the replacement of property abandoned, to make uniform provisions in all of the additions and betterments accounts under which the abandonment of any property may take place. Such rules were to the effect that the charge to additions and betterments (property accounts) be limited to the excess cost of the new or improved structure or facility over the cost to replace in kind the structure or facility retired, and that the cost to replace in kind the structure or facility retired, less salvage, be charged to operating expenses.

It may be well to point out the principles underlying the distinction which is made in account No. 5—grade revisions and changes of line—with respect to grade revisions involving the reduction of grades by cutting down summits and raising sags without material change in the alignment on the one hand, and the provision for changes of alignment and changes of line on the other. The classification assures that the carrier will ultimately obtain the best and most practicable location for its line, whether upon the right of way previously used before the grade reduction was made, or upon a different location on a new right of way. It has not been assumed that the carrier will select a more expensive method of reducing grades because of any accounting requirement of the commission. It is on the contrary to be assumed that in the exercise of ordinary business prudence whatever work is done will be done in the manner in which, and at the place at which, it may be accomplished with the least expenditure of time and money. If, therefore, the carrier does elect to reduce its grades upon the old right of way, the rules permit that the additional grading done may be included in the additions and betterments (property) accounts. This is on the theory that had the line originally been built upon the improved grade the total amount of grading then done, the cost of which would properly be reflected in the property account, would amount to approximately the same as the cost of grading in connection with the first location plus the cost of additional grading done in cutting down the summits and raising the sags, and that, therefore, such a method of reducing the grade involves no abandonment of property.

I just notice, however, that even the text of this portion of the account provides that a deduction shall be made for the cost of replacing any of the grades or other property abandoned or removed, so that if there is any abandonment involved in reducing a grade on the old line, the rule provides for its elimination from the property account; I mean the elimination of the abandoned property.

It should be noted that in such a case the provisions of note A under this account require that the cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; the cost of raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks, the cost of reballasting, lining, and surfacing tracks on completion of work, and other similar items which do not add to the value of the property are required to be charged to operating expenses. Very similar provisions are made in account No. 16—improvement of over and under grade crossings—and No. 17—track elevation, elimination of grade crossings, etc.

It is, I understand, claimed that the classification of operating expenses provides no accounts to which a carrier may charge the cost of replacing in kind property abandoned. The classification of operating expenses prescribes primary accounts under maintenance of way and structures in operating expenses under the following captions:

Superintendence; ballast; ties; rails; other track material; roadway and track; tunnels; bridges, trestles, and culverts; over and under grade crossings; grade crossings, fences, cattle guards, and signs; snow and sand fences and snowsheds; signals and interlocking plants; telegraph and telephone lines; buildings, fixtures, and grounds; docks and wharves; roadway tools and supplies; other expenses.

By Mr. WICKWIRE:

Q. Mr. Lutz, to what classification of operating expenses are you alluding in making this statement?—A. Third revised issue.

Q. How was it in regard to the other issues?—A. Well, the third revised issue is the only issue which has been promulgated since the adoption of the Hepburn Act. I am not just at the moment familiar with the list of accounts in the old classification. It did not occur to me as being material.

By Mr. DENISON:

Q. Mr. Lutz, have you prepared this statement which illustrates the disposition to such accounts as those you have just mentioned of the charges involved in this particular matter for the fiscal year 1910?—A. Such a statement was prepared.

Q. Under your supervision?—A. Under my supervision.

Q. Is this it?—A. But I am under the impression that it was prepared without reference to a rule which I am just about to read, and perhaps might not reflect the exact situation under the application of that rule: With particular reference to the changes of alignments and grades, the text of the primary accounts "Roadway and track," in the classification of operating expenses, provides as follows:

Changing alignment and grade—

By Mr. WICKWIRE:

Q. What part is that?—A. Roadway and track.

Q. What is the number?—A. It is not numbered, I think, but I can find it for you in a moment.

Changing alignment and grade: The proportion chargeable to operating expenses of cost of material used and labor expended in changing the alignment and reducing grades.

That is the text. That is on page 26 of the classification of operating expenses third revised issue.

The texts of these various accounts define the items which are chargeable to each and provide that any such items of expenditure incurred in repairing or renewing the various facilities provided for should be charged to the accounts indicated. The provisions of the classification of additions and betterments for charges to operating expenses on account of abandoned property restrict such charges to the cost of replacing in kind the property abandoned. It therefore appears clear that the cost of replacing in kind the property abandoned is neither more nor less than a renewal charge, and as such is clearly covered by the text of the various accounts in the maintenance of way and structures group in the operating expenses classification. As an illustration, suppose, for instance, a carrier should have destroyed by flood a considerable portion of its road, including bridges and other structures. The operating expense accounts prescribed do provide appropriate headings under which the cost of renewing this destroyed property should be charged. For instance, the cost of ties replaced would be charged to the accounts provided for "Ties"; rails, to the account provided for "Rails"; the grading and labor incident to laying rails and ties, to the account provided for "Roadway and track." Any bridges renewed would be charged to the account provided for "Bridges, trestles, and culverts." Any necessary renewal of buildings would be charged to the account provided for "Buildings, fixtures, and grounds." It is the intention that these accounts, in so far as they are applicable to the class of property abandoned, be used in charging to operating expenses the cost to replace in kind any such abandoned property, and it is believed that an appropriate account will be found for every element entering into the cost of replacing any property which is by the classification of additions and betterments required to be charged to operating expenses.

By Mr. DENISON:

Q. Have you had prepared, under your instruction, a condensed statement of the income account of the petitioner railroad for five years ending June 30, 1911?—A. I have, as an abstract from the annual reports filed by the Kansas City Southern Railway Company for those five years.

Q. Is this the statement or paper referred to?—A. It is.

Mr. DENISON. I offer that in evidence.

Mr. WICKWIRE. There is no objection to this, subject to verification and correction, if any errors are found. We have not had an opportunity to compare it with the figures.

The statement referred to was received in evidence and marked "Respondent's Exhibit P" and is filed herewith.

## RESPONDENT'S EXHIBIT P.

*Abstract from the annual reports filed by the Kansas City Southern Railway Company, showing condensed statements of income account for five years ending June 30, 1911.—Interstate Commerce Commission.*

Accounts.	Fiscal year ended June 30, 1907. <sup>1</sup>	Fiscal year ended June 30, 1908.	Fiscal year ended June 30, 1909.	Fiscal year ended June 30, 1910.	Fiscal year ended June 30, 1911.	Total, five years.
	<i>Dollars.</i>	<i>Dollars.</i>	<i>Dollars.</i>	<i>Dollars.</i>	<i>Dollars.</i>	<i>Dollars.</i>
Operating revenues.....	8,728,758.30	8,758,928.70	8,771,965.39	9,594,651.58	9,965,173.89	45,849,477.86
Operating expenses.....	5,203,248.82	5,754,320.87	5,350,056.21	6,268,584.67	6,404,000.36	28,980,511.53
Net revenue.....	3,525,509.48	3,004,607.83	3,421,909.18	3,326,066.91	3,561,173.53	16,860,266.30
Taxes.....	183,849.08	283,138.48	322,279.42	343,771.00	361,875.32	1,494,915.30
Operating income.....	3,341,660.40	2,721,469.35	3,099,629.76	2,982,295.91	3,229,298.21	15,374,351.00
Other income:						
Hire of equipment.....	129,483.67					129,483.67
Dividends on stocks owned.....						
Interest on bonds owned.....	36,105.48	32,502.00	23,253.00	15,338.50	14,821.42	122,020.40
Miscellaneous income.....	131,848.52	107,750.13	81,698.15	96,563.31	117,700.57	535,560.68
Total other income.....	297,437.67	140,252.13	104,951.15	111,901.81	132,521.99	787,064.75
Gross corporate income.....	3,639,098.07	2,861,721.48	3,204,580.91	3,094,197.72	3,361,819.60	16,161,415.75
Deductions from income:						
Hire of equipment.....		918.47	77,498.35	232,087.72	286,596.75	597,101.23
Interest on funded debt.....	1,183,759.00	1,225,652.78	1,221,600.00	1,266,462.32	1,382,455.99	6,279,909.09
Other interest.....		6,653.67	7,278.60	17,588.64	2,201.30	33,722.41
Other deductions.....		12,581.72	21,688.64	86,776.05	23,676.02	144,722.43
Total deductions from gross corporate income.....	1,183,759.00	1,245,203.61	1,328,066.59	1,602,914.73	1,694,900.30	7,054,840.25
Net corporate income.....	2,455,339.07	1,616,517.87	1,876,514.32	1,491,283.99	1,666,919.30	9,106,569.49
Disposition of net corporate income:						
Dividends declared on preferred stock.....	840,000.00	840,000.00	830,860.00	830,860.00	830,860.00	4,390,580.00
Account of sundry adjustments.....	82,531.03					82,531.03
Reserves for replacements and adjustments not heretofore provided for.....	100,000.00					100,000.00
Balance carried to profit and loss.....	1,432,808.04	776,517.87	1,036,654.32	651,423.99	827,059.30	4,724,458.46

<sup>1</sup> The accounts for the year 1907 were reported under the classification of accounts used before the uniform system of accounts became effective. The figures as reported in the annual report of the carrier have been revised by transferring "Switching charges" from operating expenses to operating revenues and "Hire of equipment—Credit balance" from operating revenues to other income to agree with the returns of these items for the succeeding years. In the accounts for that year the rent feature of the joint facility debts and credits was included in the operating accounts. This doubtless is the cause for no amount being shown for "Other deductions" from gross corporate income for that year.

By Mr. DENISON:

Q. Mr. Lutz, have you now in your possession the documents which you referred to this morning in connection with your testimony, and which were then not here?—A. I have, and they have been filed.

Mr. DENISON. For the purposes of the record, I think, perhaps, I should now make a formal offer of all the documents referred to by Mr. Lutz in his testimony, which are marked in a series, "exhibits C. A. L. 1 to 12, inclusive, some of the intervening numbers being omitted.

The exhibits referred to, being exhibits C. A. L. 1, 2, 3, 4, 5, 8, 10, 11, and 12, were received in evidence, and are filed herewith.

Mr. WICKWIRE. There is no objection to these, which I now assume to be offered, which are exhibits marked C. A. L. Nos. 1, 2, 3, 4, 5 and 8. I suppose this offer does not relate to the letters which were offered this morning?

Mr. DENISON. No.

Mr. WICKWIRE. With respect to those others, if your honor please, as the ruling upon whether they should be admitted or not is to be reserved for the full bench, it occurs to me that it might be well to have an understanding that, in case the court should ultimately rule that these particular letters are admissible an opportunity should be given the petitioner to introduce the other letters relative to the same matter received from the executives of various railroad companies taking a view contrary to that set forth in these letters. It is my understanding that these letters include only a small fraction of the total number of letters received by the commission, and that about five-sixths of all the letters received took a position contrary to that expressed in these letters. Now, if these letters should ultimately go in, it would, of course, be only fair to the petitioner to have an opportunity to introduce the balance of those letters, so as to make a complete record before the court upon that particular matter.

The COURT. The way that matter is disposed of in the new rules prescribed by the Supreme Court of the United States, covering rules in equity cases in the circuit courts of the United States, the court to which the case is appealed or in which the case is tried shall determine, if the evidence is admissible, is to make such orders as shall be just and equitable; so if the full bench decide that these letters are admissible, the court will at that time make such orders as will allow you, of course, full opportunity to meet that.

Mr. WICKWIRE. Yes; I simply wanted to suggest it at this time.

The COURT. Yes.

Mr. DENISON. Would it not be desirable, your honor, to have the situation such that the case could not be reopened for further testimony? We are perfectly willing to concede that there were a number of letters, a considerable number, that took the contrary view. All that we are interested in is to present to your honor the fact that there was a burden of opinion which favored the rule as ultimately promulgated. We are perfectly ready to concede that a considerable number took the contrary view, but I doubt that five-sixths of them did. We are ready to concede that there were more letters that took the contrary view, and I do not see why that is not sufficient for the purposes of counsel. I mean we are willing to concede that there were letters from the executive officers of the railroads which took the other view.

The COURT. That is a matter between counsel, of course. It is nothing for the court.

Mr. WICKWIRE. My position is that these are irrelevant, and I wish to stand upon my objection.

Mr. DENISON. I have here all I could find in the files which took the opposite view. I can submit them to counsel and he can look them over if he wishes, and I think he might put them in contingently tomorrow.

Mr. WICKWIRE. I do not care to waive my objection by introducing evidence which I claim is incompetent.

Mr. DENISON. Well, I do not ask him to introduce evidence but I think they might be marked for identification, so that if the contingency arises, it will not be necessary to get a postponement to take further testimony.

The COURT. It seems to me it is purely hearsay on the issues involved here, with no opportunity to cross-examine witnesses. It seems that the only way is to let the record stand as it is at present.

By Mr. DENISON:

Q. Mr. Lutz, there was a dispute not only in the meetings of the committee of twenty-five but in the correspondence which was submitted to you, and through you to the commission, was there not, on this question?—A. There were varying views held by different people.

Q. There were varying views?

Mr. WICKWIRE. One moment. If this is material, what is contained in this correspondence I think should be presented.

Mr. DENISON. I was laying the foundation for that.

Mr. WICKWIRE. Well, I think the best way is to offer documents.

Mr. DENISON. I am laying a foundation for it.

Mr. WICKWIRE. Well, I move to strike out the question as calling for a conclusion of the witness and stating the contents of written documents and as mere hearsay.

Mr. DENISON. I can at least offer the documents.

The COURT. What is the question?

The Reporter (reading): Mr. Lutz, there was a dispute not only in the meetings of the committee of twenty-five, but in the correspondence which was submitted to you and through you to the commission, was there not, on this question?

A. There were varying views held by different people.

The COURT. The question is improper, as calling for the contents of these letters. You admit that part of it. If you want to show the fact that there was a dispute, that would be all right.

By Mr. DENISON:

Q. Among the letters which came to you in your study and investigation into this matter, were there some letters which took the view contrary to those which we offered in evidence this morning?—A. There were.

Mr. WICKWIRE. One moment. I object to that on the ground that it offers to state the contents of written documents, and I move to strike out the answer.

Mr. DENISON. I propose to offer the documents in evidence. I am merely trying to lay a foundation by a description of them.

Mr. WICKWIRE. I do not see the necessity for a foundation of that kind. I move to strike out the answer.

The COURT. It may be stricken out.

By Mr. DENISON:

Q. Among the letters which you received on behalf of the commission in your investigation of this matter prior to the promulgation of the rules, was there included a letter from the assistant to the president of the Delaware and Hudson Company, dated June 29, 1907, addressed to Mr. A. H. Plant?—A. There was.

Mr. DENISON. I offer that letter in evidence.

Mr. WICKWIRE. Objected to upon the same ground upon which objection was made to the other letters of the same character.

The COURT. I do not know what the letter contains.

Mr. DENISON. The letter is a letter which, as I attempted to state to your honor, states the opposite view from those which we offered this morning, and a position contrary to the rules as promulgated. That is it in substance.

Mr. NEEDHAM. I understand you are offering these now on behalf of the United States?

Mr. DENISON. Yes.

The COURT. I sustain the objection.

Mr. DENISON. I except. May that be marked for identification?

The letter referred to was marked "For identification, Respondents' Q."

By Mr. DENISON:

Q. And a similar letter from the general auditor of the Chicago, Rock Island and Pacific, dated June 25, 1907?—A. There was.

Mr. DENISON. I offer that.

Mr. WICKWIRE. The same objection.

The COURT. The same ruling.

Mr. DENISON. Exception. Let that be marked for identification "Respondents' R."

The letter referred to was marked by the reporter "For identification, Respondents' R."

By Mr. DENISON:

Q. And also a letter from the president of the Rock Island and Pacific to Mr. Adams, dated August 13, 1908?—A. There was.

Mr. DENISON. I offer that in evidence.

Mr. WICKWIRE. The same objection.

The COURT. The objection is sustained.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter "For identification, Respondents' S."

By Mr. DENISON:

Q. Also a letter from the general auditor of the Chicago, Rock Island and Pacific Railway Company, dated September 14, 1907?—A. There was.

Mr. WICKWIRE. The same objection.

The COURT. The same ruling.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter "For identification, Respondents' T."

By Mr. DENISON:

Q. And also a letter from the fourth vice president and general auditor of the Boston and Maine Railroad, dated June 27, 1907, with an inclosure, as stated?—A. There was.

Mr. WICKWIRE. The same objection.

The COURT. Objection is sustained.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter "For identification, Respondents' U."

By Mr. DENISON :

Q. And also a letter from the president of the Boston and Maine Railroad dated August 26, 1908?—A. There was.

Mr. DENISON. I offer that.

Mr. WICKWIRE. The same objection.

The COURT. The objection is sustained.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter " For identification, Respondents' V."

By Mr. DENISON :

Q. Also a letter from the president of the Northern Pacific Railway, dated July 25, 1907?—A. There was.

Mr. DENISON. We offer that in evidence.

Mr. WICKWIRE. The same objection.

The COURT. The objection is sustained.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter " For identification, Respondents' W."

By Mr. DENISON :

Q. Also a letter from the president of the Northern Pacific Railway, dated August 21, 1908, with inclosures as stated?—A. There was.

Mr. DENISON. I offer that in evidence.

Mr. WICKWIRE. The same objection.

The COURT. The objection is sustained.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter " For identification, Respondents' X."

By Mr. DENISON :

Q. Also a letter from the vice president of the Missouri Pacific Railway Company, dated September 29, 1908, with inclosures, as stated?—A. There was.

Q. Also a letter from the general auditor of the Missouri Pacific Railway Company, dated June 25, 1907, with inclosures as stated?—A. There was.

Mr. WICKWIRE. Did I understand you to offer the last one but one?

Mr. DENISON. Yes.

Mr. WICKWIRE. Well, I object to that for the same reason.

Mr. DENISON. Yes; I assumed so.

The COURT. Objection sustained.

Mr. DENISON. Exception.

The letter from the vice president of the Missouri Pacific Railway Company, dated September 29, 1908, was marked " For identification, Respondents' Y."

Mr. WICKWIRE. Now, the last one you referred to is objected to for the same reason.

The COURT. The objection is sustained.

Mr. DENISON. Exception.



The letter referred to was marked by the reporter "For identification, Respondents' Z."

By Mr. DENISON:

Q. And also a letter from the general auditor of the Lehigh Valley Railroad Company, dated June 29, 1907?—A. There was.

Mr. DENISON. I offer that.

Mr. WICKWIRE. The same objection.

The COURT. The objection is sustained.

Mr. DENISON. The same exception. That will be marked for identification "AA."

The letter referred to was marked by the reporter "For identification, Respondents' AA."

By Mr. DENISON:

Q. Another letter from the same, the general auditor of the Lehigh Valley Railroad Company, dated September 18, 1907?—A. There was.

Mr. DENISON. I offer that.

Mr. WICKWIRE. The same objection.

The COURT. The same ruling.

Mr. DENISON. Exception.

The letter referred to was marked by the reporter "For identification, Respondents' BB."

By Mr. DENISON:

Q. Many of those letters appear to be addressed to Mr. Plant and a few of them to Mr. Adams, but however they were addressed, they formed a part of the material of the investigation of the commission prior to the issue of these regulations, did they not?—A. That is true.

Q. And have you looked through the files of the commission to find whether there were any other letters than these which stated views opposite to those represented by the classification as promulgated?—I caused the files to be searched, and am told that these comprise the full file of letters of that character—that is to say, those letters which were offered this morning, together with those which are just offered.

Q. Those which were offered this morning favoring the view of the commission and those just now offered favoring the other side?—A. Yes.

Q. And the two together representing, so far as you can find, the whole correspondence which took one side or the other on that point?—A. That is my impression; yes. If your honor please, there is one point in my testimony this morning, while not perhaps material, that I would like, for the sake of accuracy, to correct.

I said that the Buffalo meeting in 1907 was the first meeting of the committee of twenty-five which I attended in company with my then superior officer—the comptroller of the Louisville & Nashville Railroad Company. I now recall that I attended one previous meeting of the committee of twenty-five, which was a meeting held at Atlantic City in April, I think it was, 1907, just before the annual meeting of the Association of Accounting Officers, which was held at Atlantic City in that month.

Q. In your opinion, would it have been consistent to treat abandoned property, where it was track, differently from abandoned

property where it was bridges, increased weight of rails, interlocking apparatus, block signals, telegraph and telephone lines, station buildings and fixtures, shops, engine houses and turntables, shop machinery and tools, the conditions causing the abandonment being the same?—A. In my opinion it would have been inconsistent to have accorded different treatment to the track from these other items which you have mentioned.

Q. The classification as proposed by the Buffalo meeting treated all those things alike and did not involve that inconsistency?—A. That is correct.

Q. But the Atlantic City revision separated the treatment of abandoned track from the others, holding the method as advised by the Buffalo meeting as to the others, but recommending the change as to the track.—A. That is true.

Q. Was there any railroad system which had in detail the same method of treating abandoned track which was substantially the same method of treating abandoned track as adopted by the commission?—A. The papers before the commission indicate that there was.

Q. I mean prior to the adoption of the rules by the commission.—A. Yes.

Q. What system was that?—A. The Atchison, Topeka & Santa Fe Railway System.

Mr. WICKWIRE. If your honor please, it seems to me this is hardly competent. I am not clear but what a statement of the general situation as to accounting may not be proper to be drawn out from this witness, but to state what was used in a particular railroad is rather irrelevant to the question presented here.

The COURT. What was the question before this?

The REPORTER (reading):

But the Atlantic City revision separated the treatment of abandoned track from the others, holding the method as advised by the Buffalo meeting as to the others, but recommending the change as to the track?

Mr. WICKWIRE. I move to strike out the answer, and object to that question as immaterial. I do not think we can take a poll here of all the railroads in the country to see just what systems were in effect. It seems to me that would be quite irrelevant to this inquiry.

The COURT. It would be some evidence that it was a reasonable regulation or reasonable rule; that is, that it was not against all precedents, if some railroad system was using it. I think it may stand.

By Mr. DENISON:

Q. Also, prior to the promulgation of the rules, had it been the practice of a considerable number of the large railroads to charge off to operating expenses, betterments, and additions in reference to relocations of track?—A. I think it was the practice among a number of the stronger lines to make charges directly to operating expenses for the cost of new and additional improvements to way and structures and new and additional equipment, in addition to making charges to operating expenses for at least the renewal value of equipment retired.

Q. In practice, they did not limit the charges to operating expenses to the renewals of equipment, but did include items involving betterments by improvement of the line or relocation of the line.—

A. Certainly as to equipment and certainly as to improvements and betterments along the line of existing tracks. As to new line and relocation of line, I am not so clear as to what the general practice was, but I do know that a number of carriers—of the stronger carriers—made these charges directly to operating expenses with respect to new and additional equipment and improvements, such as station buildings, bridges, etc., along the line, in excess of the renewal value of the property replaced.

Q. Would that involve the cost of abandonments of small pieces of line, such as these six pieces, for instance? A. Involve them in what way?

Q. Would betterments, made in substitution of a short piece of line for the original short piece of line similar to the six pieces that are involved here, be charged by the railroad that you refer to direct to operating expenses? A. I do not know that I have sufficient information to enable me to answer that specifically.

Q. What is the practice and what are the rules of the State commissions in reference to the matter here in controversy? A. Generally speaking, State commissions have adopted the rules promulgated by the Interstate Commerce Commission.

Q. Including the particular rule here in controversy? A. Yes.

Mr. DENISON. That is all.

(Cross-examination by Mr. Wickwire.)

Q. Mr. Lutz, have you had any practical experience as a railroad man in negotiating the sale of corporate securities?—A. I have not.

Q. Your experience, as I understand it, has been limited to accounting?—A. Not entirely. My first experience in the railway service was as station agent at a small station in Kentucky on the line of the Louisville & Nashville Railroad, and I may say that I occupied that position for four or five years. About 1892 I entered the auditor of disbursements' office of the Louisville & Nashville, passing a number of desks in that office until 1898, when I was made general bookkeeper of the company in the comptroller's office, holding that position and having, a portion of the time as well, the position of chief clerk in that office. I was then made assistant comptroller of the company in December, 1901, having general charge of the active accounting department of that company. That position I held until I entered the service of the commission in 1908.

Q. Will you define "operating expenses"?—A. I think I did that in my testimony this morning.

Q. I did not inquire whether you had done it this morning. I asked if you would do so now.—A. If it will please you, I will.

"Operating expenses," as I would define it, should include the cost of maintaining property devoted to the use of the company keeping the accounts and of performing the service of transportation, as applied to railroad accounts; and included in the term "maintaining the property," I would also embrace not only the cost of current repairs made in keeping the property in proper condition for operation, but as well the cost of replacing the property when it is abandoned or retired from service.

Q. Are expenditures for improvement of railroad property properly chargeable to operating expenses?—A. They are not.

Q. The purpose of a statement of operations or of accounts of operations is wholly separate, is it not, from the purpose of a property account?—A. I should say so.

Q. And if items which properly belong in the property account are incorrectly inserted in the operations account, those statements are distorted and inaccurate, are they not?—A. They are.

Q. Do you regard grade reduction as an improvement to railroad property?—A. I should say that it is, else it would not be justified. Expenditures therefor would not be justified if it were not an improvement.

Q. You understand that under the regulations of the Interstate Commerce Commission, if a revision of grade is obtained upon the original right of way, substantially all or very nearly all of the necessary expenditure is chargeable to additions and betterments and finds its way into the property account, do you not?—A. I think that is a fair statement—substantially all. I pointed out this morning that the rule with respect to that required any element of abandonment, even in connection with a reduction on the old right of way, to be charged to operating expenses.

Q. And in case the revision of grade is effected upon property immediately adjacent to the original right of way, and the use of the original right of way at that portion of the line is discontinued, will you state whether the entire expenditure for such an improvement is chargeable to additions and betterments?—A. You mean that in that event the old grade is not utilized in the construction of the new line?

Q. Yes.—A. No.

Q. I mean the old roadway is not utilized, but the new track is laid upon immediately adjacent territory.—A. I understand. The rule would require only the excess cost of the new construction over the cost of replacing in kind the abandoned property to be charged to additions and betterments, and the cost of replacing in kind the abandoned property would be charged to operating expense.

Q. Taking, for instance, the cost set forth by the petition here and assuming that the replacement cost of the line no longer used is \$400,000, and that the total expense of the improvement upon the adjacent ground is \$600,000, will you please state, then, the amount that would be charged for that improvement to capital account?—A. \$200,000.

Q. And the amount which would be charged to operating expenses?—A. \$400,000.

Q. But if that improvement were effected upon the original right of way, what amount would then be charged to capital account?—A. Involving no abandonment of grade?

Q. Yes.—A. The entire amount of expenditure.

Q. And nothing would be charged then to operating expenses?—A. Except the necessary and incidental cost of protecting traffic during the progress of the work and the replacement of ballast, replacement of ties—the replacement of any property which is not used again.

Q. Those are relatively minor items, are they not?—A. I do not know as to the amount. An engineer could perhaps testify with better effect as to that.

I understand, however, there is a considerable expense involved in protecting the traffic, on a grade reduction which is being made

on the old right of way, and that sometimes that, to some extent, influences the determination of the engineer as to the location.

Q. In case the expenditure necessary to be made upon the original right of way to get the desired grade was \$1,200,000, exclusive of these minor items chargeable to operating expenses, state to what account that sum of \$1,200,000 would be charged under the regulations of the Interstate Commerce Commission.—A. That is assuming that is the amount of the work necessary to be done on the old right of way, in getting the new grade, not including any items which the rule requires to be charged to operating expenses?

Q. Yes.—A. It amounts to \$1,200,000?

Q. Yes.—A. It would be charged to additions and betterments, account A5—Grade revisions and changes of line; and from thence goes into road and equipment or property accounts.

Q. So that in respect of the improvements involved in the grade reductions referred to in the petition in this case, assuming the correctness of the figures set forth in the petition, if these grade reductions have been made upon the original line of the right of way at an expenditure of approximately \$1,200,000, there would have been then charged that full sum to capital account, except the minor items of incidental operating expenses?—A. Accepting all your assumptions as true, yes.

Q. But as the matter stands, the grade reductions having been made upon adjacent territory, the net amount which this railroad company may now charge to its capital account is only \$200,000, or substantially a difference of \$1,000,000.—A. That is assuming the correctness of your respective figures, yes.

The theory of the difference in that rule is that in one case an abandonment of property has taken place and in the other case no abandonment has taken place, but the old property was utilized to its full extent.

Q. In the case of reduction of grade upon the original right of way where, we will say, the track is lowered a distance of fifty feet, there has been, has there not, an abandonment of that elevation of surface fifty feet above?—A. On fills, perhaps; in cuts, no; because in cuts you have utilized the cutting that was first made to get the original location, in making the lower cut.

Q. I am now speaking about that surface fifty feet above. That is no longer used, is it?—A. The use of that particular elevation has been discontinued, yes.

Q. Yes, and in that sense it has been abandoned—in the sense that it is no longer in actual use?—A. I presume you may say so. I would like to explain there, however, to get that part clear, that in the event the fills are taken off and abandoned, a portion of the grading being abandoned in the reduction of that fill would, under the concluding clause of the text in the classification, be chargeable to operating expenses as abandoned property, even when the reduction is made on the old right of way.

Q. Is it your position that this abandonment of which I spoke in this illustration, of a grade fifty feet above, is an abandonment in the same sense as "abandonment" is used in these classifications?—

A. I am not clear that it is, because as a matter of fact no property is abandoned except the grade. It is true the elevation is abandoned, but in getting the new location the cutting which was made in

order to get the old line in the cuts is just that much work done upon the final cutting down in the cuts to get the new line. And, to the extent, as I have said before, that fills are cut down and grading thereby abandoned, the rule provides that it shall be charged off to abandoned property.

Q. Let us assume a case in which a railroad 400 miles long had a very steep grade in the middle of it, and that the grades at both sides had been revised and were entirely satisfactory to the railroad company. It then was deemed proper to cut down this very heavy elevation in the middle. In doing so, the rock was cut down a distance of fifty feet and was removed, and the railroad company had no further use for that rock, and therefore threw it off on the dump as refuse and abandoned it. Do you maintain in that case that there is no abandonment of property?—A. Do you mean where the material is taken out of a cut and thrown away in order to get a lower line?

Q. Yes.—A. The situation is precisely the same as if the company had in the first instance reduced that hill by cutting out the entire amount of material which, in the instance which you have outlined, it accomplished by two operations.

Q. The point that you made as distinguishing this abandonment of an elevation of fifty feet above was that there was no actual property abandoned, because the earth or rock taken out was used elsewhere and was still used by the company. If it is not used elsewhere, but thrown away, you would then concede, would you not, that there had been an abandonment of property in that case?—A. I beg your pardon. I think I made no such statement, and I do not think my statement is susceptible of that construction.

Q. You stated that in case you utilized the original cutting. Explain what you meant by that.—A. I will be glad to. Here is a little sketch I have drawn to illustrate, and I will be glad to have you step here so the court may see it at the same time.

We will say that "A" lines represent the original line of the cut and the track is at the bottom of the cut. The "B" lines represent the new line, the cutting which was made to get the new cut, necessitating the removal of the earth between the lines "A" and "B." In order to obtain location "B" initially in that cut, it would have been necessary at that time, if it had been done all in one operation, to also have removed the earth inside of "A" which was removed in the first operation, so that any cuts or cutting which was done on the original line is just that much work done toward getting the larger cut or deeper cut, which it is necessary to obtain in order to get the new line.

Q. Yes; but my point is, do you not in selecting the new location at "B" abandon the upper elevation which you had at "A" before?—A. I do not think so, in the sense of abandonment as used in the classification.

Q. You admit that if the line of the railroad is moved east or west a distance of fifty feet upon adjacent ground there is then an abandonment?—A. If there is grading which is not utilized in obtaining the line on the new right of way, that is true.

Q. But if your change is vertical instead of lateral, then you contend there is no abandonment?—A. That is my position.

MR. DENISON. I would like to offer that little sketch as an exhibit. It will clarify the testimony.

MR. WICKWIRE. There is no objection.

The sketch referred to was thereupon marked "Respondent's Exhibit CC," and is filed herewith. (Not printed in record.)

By MR. WICKWIRE:

Q. Let us assume that a railroad ran along the side of a precipitous mountain, upon a ledge, and that as a part of a program of improvement it became necessary to reduce the grade of the railroad along the side of the mountain fifty feet; that to the right about fifty feet was another ledge lower down a distance of fifty feet which was suitable for the new roadway, for the roadway upon the desired grade. Is it your opinion that it is a reasonable regulation which would permit the railroad company to charge to capital account the entire expenditure for cutting down that upper ledge through solid rock a distance of fifty feet, and that that could be financed by an issue of capital, while if the track were relocated a distance of fifty feet to the right it could be placed upon the desired grade at a trifling expenditure, far less than the expenditure by the first method, but that in the latter case the expenditure for making the new grade would not be chargeable to capital account, except a portion, after deducting the estimated replacement cost of the first piece of track?—A. Your question is, Is that a reasonable distinction to make?

Q. Is that a reasonable regulation, in your opinion?—A. It is.

By MR. DENISON:

Q. You are not approving the finance as a business proposition, but simply the method of accounting?—A. Simply the regulation of the method of accounting is all I attempt to pass upon. In other words, it is my view that it is the function of the property account to reflect the cost of the property in operation, the cost of getting the line at the point at which it ultimately appears, and only such cost, and should exclude the replacement cost of any property which had previously been used and abandoned in connection with the matter of obtaining the new line.

By MR. WICKWIRE:

Q. It is, then, your view that the property account should only show, and should only contain, an amount representing the property which would now be found upon taking a physical inventory of the railroad property?

MR. NEEDHAM. I do not think that is quite a right statement, Mr. Wickwire, if I may question that.

MR. WICKWIRE. I am inquiring if that is his view. That is my question, and I would like to have an answer.

MR. NEEDHAM. The balance represents the property account on both sides and shows the history of the whole transaction. I think that has been the statement that has been made here right along.

THE WITNESS. The balance should represent the cost of the property which an appraiser would find in making a valuation of the property, in my judgment.

By Mr. Wickwire:

Q. And nothing else?—A. And nothing else.

Q. Would an inventory of the physical property of the railroad reveal a scaffolding or false work necessary in the construction of a bridge?—A. If made by an engineer who is familiar with the way in which structures of that sort are constructed, yes.

Q. Do you mean that while he could not see it, it would be tangible?—A. He would know from his knowledge of how those things are done that it must have been there and make proper allowance for it.

Q. That, then, is a modification of the rule you previously stated, that the property account should only show what would be revealed upon a physical inventory.—A. I think I said the cost of what would be revealed upon physical inventory. That, in my judgment, would be part of the cost which it would be quite competent for an engineer to take into account.

Q. Suppose, during the process of construction of a railroad, a portion of the line had been built at a particular place and it was found necessary or desirable to change that location and to discontinue the use—to abandon it, to use your word—of that portion of the track originally laid down and constructed; will you state where the cost of the original so-called abandoned portion of the line would go?—A. Did I understand you to say that the original line had been used?

Q. No; this is during the process of construction.—A. And a temporary or experimental line had been made, which it was afterwards found necessary to abandon?

Q. Not an experimental line, but a line.—A. Would it not have been an experimental line if it had been made under those circumstances?

Q. I am asking you to assume that it is the regular line.—A. That is a very difficult thing for me to assume, because I can not imagine such a situation.

Q. That is beyond your imagination?—A. Yes; to assume that that was other than an experimental line which it has been found afterwards was not the proper line to use.

Q. Suppose, during the process of construction running over a period of two or three years, it should be found, by reason of an extraordinary freshet, that the location of the road at a particular line was too low, or too near a river, and that it was therefore desirable and necessary, for the safety of operations, to relocate that portion of the line upon other ground; will you state to what account the cost of the original track upon the original location would be chargeable?—A. That would remain in the road and equipment accounts along with the cost of the new one.

Q. Would that be found at the present time as cost of the property visible upon taking an inventory?—A. I suspect some trace of it might be found, and the circumstances under which it was constructed could be ascertained by the appraiser.

Q. But your definition implies the property which is now in use is all that can go into your property account.—A. I said the cost of the property now in use.



Q. The cost of the property now in use?—A. Yes.

Q. That property is no longer in use, is it?—A. No; I presume that, assuming that you call that a separate property, it is not in use.

Q. Then you admit there are other items which properly will go into a statement of property accounts than those embodied in your original statement?—A. No, I think that is comprehended by the general statement "the cost."

Q. But you have stated that it is the cost of property now actually in use, and this you have already said is no longer in use.—A. Then I will modify my statement to the extent that it will say that the property account should reflect the cost, taking into consideration all the elements of construction cost during the construction period leading up to the completion of the structure as turned over for operation.

Q. Then the distinction which you make as to whether the cost of the property no longer in use should be included in the property account or not is based solely upon the element of time as to when the use of the property is discontinued? If it is immediately before operations are commenced, it is chargeable to property accounts; but if it is shortly after operations are commenced, then you treat it as an abandonment. Is that correct?—A. That is true.

Q. And then you charge it off to operating expenses?—A. Yes.

Q. In this case it is in evidence that the cost of the improvements thus far made by changes of location amounts to between \$700,000 and \$800,000 and that a large number of additional grade revisions are being made at an expenditure running up largely in excess of that sum. Assuming that in a particular year the net revenue of the railroad is \$1,000,000, and that by reason of changes of grade which it had effected during the year by relocations, the amount chargeable to operating expenses under the classifications of the Interstate Commerce Commission was \$1,000,000, then in the statement which the company would be required to file with the commission and which would be published and given to the stockholders, the report would show that the company had had no net earnings whatever, would it not?—A. That would be true unless the company had availed itself of the first option given by the commission to set up reserves in advance to take care of at least a portion of the abandonment, or if it did not avail itself of the third option of the commission of charging abandoned property to a special account and charging it over operating expenses of the future.

Q. My question assumes that none of these things are done by the railroad company, and in that event the statement which the company must file with the Interstate Commerce Commission, in order to comply with the law, will show that the company has had no net earnings whatever during that year, will it not?—A. Assuming, as I said before, that neither of the options to which I refer were availed of, that would be true.

Q. I have already assumed that in my question.—A. And I have answered it in my answer.

Q. And the officials of the railroad company are required to swear to that report as an accurate statement of facts, are they not, under the regulations of the commission?—A. I think they are. Their annual reports are rendered under oath. Under the orders of the commission I think the accounting officer is expected to be responsible

for the application of the rules laid down by the commission as to accounts and to render reports upon forms provided by the commission in accordance with the accounting rules and the reporting rules prescribed by the commission.

Q. And it is your opinion that regulations which produce that result are entirely reasonable?—A. I think regulations which give the three options to which I have referred, which permit the carrier to make use of either of the three it elects, are reasonable to require the return to be made reflecting the results according to the option exercised by the carrier.

Q. Will you please answer my question as to whether you regard the regulations of the commission, which alone are involved in the making of such report as that which I have cited, are reasonable?—A. I think they are.

Q. Let us assume in the case of expenditures of this nature, which would require under the regulations a charge of one million dollars to operating expenses, that that amount were distributed over a period of ten years, amounting to one hundred thousand dollars for each year, and suppose the net earnings of the company during each of these ten years were one hundred thousand dollars per year. Then, in that case, spreading this charge over the ten years, the company's annual reports would show during each of those ten years that the company had made no earnings whatever, would they not?—A. I think that necessarily follows.

Q. Assuming that the company during each of these years over which the charges are spread had a net earning of fifty thousand dollars a year, then would the report made to the commission show that the company had sustained a net loss upon its operations of fifty thousand dollars per year during each of those ten years?—A. I think that is obvious.

Q. Is it your understanding that the provisions that these charges may be spread over a term of years in the discretion of the commission are designed to cover cases in which otherwise a hardship might be worked upon the carrier?—A. I think that is what that is designed for. The text of the provision, as I recall it, is that in case the amount chargeable to operating expenses for property abandoned directly in connection with improvements is relatively large, and its inclusion in the carrier's operating expenses for a single year would unduly burden those accounts for that year, the company may, if so authorized, etc., spread it over the future.

Q. That is designed, as you understand it, to cover cases in which otherwise hardship would be worked to the carrier?—A. I think that is true.

Q. Then, the question of whether a hardship shall be worked to the carrier is left entirely to the discretion of the commission?—

A. The question as to whether the use of this account in this way is permitted is left to the discretion of the commission.

Q. So that, assuming a case in which the enforcement of this regulation, without application for relief to the commission, would work a hardship, and assuming that application was then made to the commission and the commission refused to grant relief, the result would be that a hardship would be worked upon the carrier?—A. I think that follows inevitably.

Q. Let us assume, Mr. Lutz, that the railroad company had made a reduction of grade by means of a new location and retained, for a year or two after the completion of the work, the old line in use either as a double track or for storage purposes, or switching, or something of that kind; in that event the expenditure necessary to make both of those sections of track would be carried in the capital account, would it not?—A. That is true. No rule of the commission can compel abandonment of property.

Q. Suppose that after two or three years the corporation decides that it will abandon the old segment of track, then is any charge made to operating expenses?—A. If the rule providing for abandonment of property which is not replaced is met in good faith, that would be true.

Q. So that the question here, then, resolves itself down to this, that in case that portion of the track originally used should be kept for two or three years and then abandoned, the operating account of this company would never feel or reflect the cost of that abandonment. A. If, in fact, it is an abandonment under the provisions there made, which is not replaced, that is true.

Mr. DENISON. You mean if the keeping is a real bona fide keeping and not a mere fiction?

By Mr. WICKWIRE:

Q. That is my question; that is what I assumed.—A. That is my assumption in making the answer.

By Mr. DENISON:

Q. That the keeping is a real bona fide thing?—A. That the abandonment, not replaced, is in good faith.

By Mr. WICKWIRE:

Q. In other words, if one management, after these relocations or changes of grade were made, should regard it good policy to keep the old portions of that track in use, and a new management should come into control of the road which took a contrary view, and then abandoned the first line of track, the cost of that track would not be charged to the operating expenses. Is that correct?—A. That is true. As I said before, the classification of accounts can not control the corporations in what they shall or shall not do respecting abandonment, but are simply to reflect, under the rules provided, what has been done.

Q. They should reflect, should they not, what money is earned from operations?—A. They should.

Q. And in one case, if the property is abandoned incidentally to the making of a grade reduction, the operations bear the cost of the line abandoned, while in the other case which I have cited of an abandonment a little later the operations do not reveal the cost of the abandoned property.

Mr. NEEDHAM. What do you mean by operations?

Mr. WICKWIRE. The operations accounts.

Mr. NEEDHAM. The operating account, you mean?

Mr. WICKWIRE. Yes.

The WITNESS. Yes; to that extent I would say that the accounts are susceptible of that treatment.

By Mr. Wickwire:

Q. Do you think the system of accounting promulgated relative to this matter results in making a true and accurate statement of the net profit on operations in these two cases?—A. The operating expenses—

Q. (Interrupting.) Will you be good enough to tell me whether you think that?—A. I was going to do so. The operating expenses with respect to an abandonment of property which is not replaced, theoretically at least, should be charged, during the period prior to its abandonment, for the value of the property which is abandoned, through depreciation charges. The carrier can not always foresee that such abandonments will be made, and therefore, perhaps for that reason and perhaps for others, may not have set up depreciation charges in advance of the abandonment. If the property is abandoned and no longer used, and no other property is substituted for the same purposes or use—bear in mind, no other property is substituted for the same purpose or use—and I would say that in order to show good faith there would have to be a considerable period, just from my personal view, elapse between the time of the construction of the new line and the abandonment of the old to make it clear to me that the matter was handled in good faith—then the property which was abandoned would have to be charged to profit and loss, because there would be no future earnings or anything of the kind against which to charge it—bearing in mind that no other property for like purpose or for like use is substituted for the abandoned property.

Q. Reverting to my question—A. (Interrupting.) I should say—just one further explanation, if I may—that I am not quite clear that a second track abandoned would fall under that rule, because I should think if you abandon the second track you would throw your traffic right over on the other track which was there, and that would be other property for like purpose and use. That rule was intended to take care of the abandonment of entire branches of lines, where you reach out into a territory and take the track up and do not build any other road to take the place of it, and do not reach the traffic which was formerly reached by it; and it, to my mind, would be used in the exceptional cases and would hardly cover the case which you have indicated.

Q. Reverting to my question, you have already stated that in the one case of the two which I cited the cost of the portion of the track discontinued would be charged into operating expenses and in the other case it would not. I will ask you again if you will be good enough to state whether you think the regulations are so devised as to reveal in those two cases the truth in respect to what the net earnings of the company have been?—A. The operating expense accounts of the period prior to an abandonment, under the theory of depreciation, should have been charged with the value which was going out of the property, which was finally abandoned. If it is abandoned and is no longer used, and there is no other property put in for the purpose or use—

Q. (Interrupting.) Why do you assume a new case when I have asked you a very simple question here and have asked you to state whether you believe that in these two cases the regulations do re-

quire a correct statement of the operating expenses?—A. I was attempting to explain that when I was interrupted.

Q. We have had your explanations. I should think you could tell us either yes or no, whether you think that in both these cases the regulations do require a correct and truthful statement of what the operating expenses of the road have been.—A. Assuming that it was impossible to have foreseen the abandonment and that the operating expenses prior to abandonment could not have been charged for that reason, it is the best that can be done under the circumstances.

Mr. WICKWIRE. Mr. Reporter, will you be good enough to read the last question?

The REPORTER (reading):

We have had your explanations. I should think you could tell us either yes or no, whether you think that in both these cases the regulations do require a correct and truthful statement of what the operating expenses of the road have been.

By Mr. WICKWIRE:

Q. Will you be good enough to answer this question?

Mr. NEEDHAM. That refers back to a former question which has rather passed out of my own mind.

Did you assume in that question that the continuance of the line for a year or two was done in good faith by the company and then the policy of the company changed and it abandoned it?

Mr. WICKWIRE. That was expressly stated in the question, and counsel for the Government has already made that inquiry, and the witness has already stated that he so understood it.

The WITNESS (after a long pause). Are we waiting for something?

By Mr. WICKWIRE:

Q. We are waiting for your answer.—A. I think you have it.

Q. Will you be good enough to answer the last question?—A. Read it to me, Mr. Reporter.

The REPORTER (reading):

We have had your explanations. I should think you could tell us either yes or no, whether you think that in both these cases the regulations do require a correct and truthful statement of what the operating expenses of the road have been.

The WITNESS. To the extent that the regulations fail to provide for the depreciation charges in advance and fail to require them, I should say that they are defective to that extent.

By Mr. WICKWIRE:

Q. But as I understand it, the compliance by the carriers with these regulations will not always result in an accurate statement of the operating expenses.—A. To the extent that they fail to set up adequate depreciation charges for abandonments, that is true.

Q. So that in certain cases the carrier, under the regulations of the commission, is required to make statements to the commission which do not accurately portray the state of the operating expenses.—A. That is my view from a theoretical standpoint. From a practical standpoint, taking into account the methods which have been in use in railroad practice, that is not necessarily true.

Assuming that the abandonments of property from time to time are practically uniform, as in connection with the equipment of the carrier which is about half worn out, the charges made from time to time as and when the renewals take place would probably approximate depreciation charges.

Q. You say this is theoretically true, but then you refer to some other matters from a practical standpoint. Do you understand that there is any difference in truth from a theoretical standpoint and truth from a practical standpoint?—A. No.

Q. Then if these statements which the carriers are required to make under the regulations of the commission may under some circumstances not reflect the truth, is it your opinion that they would be correct practically; that if they are untrue they would be practically correct?—A. I do not believe that they would necessarily be untrue, having in mind the conditions as they existed from year to year as the accounts were kept prior to abandonment.

Q. The purpose of this statement of accounting is to show the truth, is it not?—A. As nearly as may be.

Q. And you have already stated that under some circumstances these accounts, if made in accordance with the regulations of the Interstate Commerce Commission, would not be true. Under these circumstances, do you regard these regulations, which require the accounting officers of the railroads to make these statements under oath, as reasonable?

MR. NEEDHAM. I object to that question, because I do not understand that he has said those accounts were not true. As I have understood the witness, he said they ought to anticipate these depreciations and provide for them in advance. That was his theory of the way in which it ought to be treated; but the counsel started out with the proposition with reference to an abandonment which was not made at the time, but was made by change of policy several years afterwards. The fact that in the latter case it is charged to profit and loss and not to operating expenses is chargeable not to the system of accounting, but to a change of policy of the company.

I do not understand that the witness said that was untrue.

THE COURT. Read the question again, Mr. Reporter.

THE REPORTER (reading): And you have already stated that under some circumstances these accounts, if made in accordance with the regulations of the Interstate Commerce Commission, would not be true. Under these circumstances, do you regard these regulations, which require the accounting officers of the railroads to make these statements under oath, as reasonable?

THE COURT. I think the witness may answer.

THE WITNESS. I do not think I stated that the accounts would be untrue.

By MR. WICKWIRE:

Q. Did you not state that theoretically they would not be true?—A. Perhaps I should have amended that by saying that the proper time, in my judgment, for the taking care of depreciation charges is in advance of abandonment. If the management had failed to do that, then the operating expenses would not reflect the real situation.

Q. Then am I to understand that you desire to withdraw your statement that under some circumstances those might not be theo-

retically true and that you now mean to assert that they do truthfully reveal the facts in all cases?—A. Would you kindly have the reporter read to me the statement which I made to which you refer?

The Court. It is somewhat past our usual adjourning time. We will take a nadjournment until half-past ten to-morrow morning.

Thereupon, at 4.45 o'clock p. m., the court adjourned until to-morrow, Friday, December 13, 1912, at 10.30 o'clock a. m.

WASHINGTON, D. C., *Friday, December 13, 1912.*

At 10.30 o'clock a. m. the court convened pursuant to the adjournment of yesterday afternoon.

Present: Judge Carland.

Appearances: Mr. Wickwire, for the petitioner; Mr. Denison, for the respondent; Mr. Needham, for the Interstate Commerce Commission.

Mr. NEEDHAM. If your honor please, I have two witnesses who are anxious to get away, and if it is agreeable I should like to interrupt the examination of Mr. Lutz and put them on the stand. They are important railroad men and are away from home and anxious to get back.

The Court. That is all right so far as I am concerned.

ROBERT L. FARRINGTON, a witness of lawful age, called by and on behalf of the intervening respondent, being first duly sworn, is examined.

By Mr. NEEDHAM:

Q. Will you please state your name and position?—A. Robert L. Farrington, vice president of the Great Northern Railway Company, St. Paul.

Q. Where are you located?—A. St. Paul, Minnesota.

Q. You were present yesterday and heard the discussion and know the subject of controversy in this suit?—A. I was present during the afternoon only, but I understand the subject in controversy here, I think.

Q. The question involved in this case is the propriety or the reasonableness of the rule requiring abandoned property of the character described in this case, being taken from the property account and charged to operating expenses. How long have you been in the railroad business, and what positions have you occupied?—A. I have been in the railroad service 30 years and I have occupied positions in the accounting department, of clerk, auditor of disbursements, assistant comptroller, comptroller, and vice president.

Q. With what roads have you been connected?—A. The Northern Pacific first, what was called the Cairo, Vincennes & Chicago line, now part of the Big Four; the Illinois Central; the St. Paul, Minneapolis & Manitoba Railway Company, which is now known as the Great Northern Railway Company.

Q. Your work has been in that field?—A. About 25 years in the accounting department.

Q. Assuming that the purpose of a classification of the accounts of railroad companies is to make the balance of the property account

at any given time show the cash or cost value. I will use "cost" and not "value"—the cost of the existing road or property that can be inventoried at a given time, state whether or not, in your opinion the rule of the Interstate Commerce Commission in this regard is a reasonable rule. A. Do you refer to property entirely abandoned, property partially abandoned and used in the construction of an improvement?

Q. As applied to abandonments in controversy in this case, where parts of the road have been abandoned in process of reducing grades, the parts being substituted by a new line. A. In my opinion the rule is a reasonable rule.

Q. Will you state now the reason why the reconstruction value of this abandoned property should be credited out of the property account? A. In my opinion the property account should not show the value of anything that has really been abandoned and is not now used. I think that the cost should be charged off to operating expense, because in my opinion operating expense not only includes the cost of carrying on the operation, but the wear and tear and general use of the property, some of which is tangible and can be covered by repairs, and some of which you might call intangible and spread over a good many years, and can not be charged currently, but has to be provided for in some way or other, and if provided for by depreciation there will be no occasion to charge operating expenses, and if not provided for in depreciation, it ought to be charged to expenses.

Q. Would you include in depreciation losses caused by inadequacy of the line or inadequacy of the equipment to carry the traffic to meet the demand upon it? A. I should cover that by depreciation, yes.

Q. Would you cover by depreciation these losses which are occasioned by what is called obsolescence? A. Yes.

Q. Would that apply to the truck and railroad as well as to equipment? A. In my judgment, yes.

Q. The theory then, as I understand you, is that in good accounting the property account should contain a complete history of all that has been contributed and of all that has been abandoned, both on its credit and debit sides? A. Yes.

Q. So that the balance would represent the total cost of the existing property? A. In my judgment, yes.

Q. I also understand you to say that the operating expense account should cover not only depreciation by wear and tear and sudden accident, but also depreciation which arises from inadequacy and from obsolescence? A. Yes, sir.

Q. That would make the operating expense account show year by year the total expense of operating the road and maintaining its efficiency at whatever standard the business management determined? A. Yes, sir.

Q. Where depreciation from inadequacy is anticipated—that is to occur in the future and is anticipated by a railroad company—how could that be met under the rules of the Interstate Commerce Commission? A. It is my understanding that the commission permits a carrier to charge in its operating expenses depreciation, and set up a fund; that is, the consent of the commission has first to be obtained, and that can be handled in that manner.

Q. That is to say, if the business management foresees that during a period of ten years in the future, we will say, the road will grow



more and more inadequate to carry developing traffic and that it will have to abandon either curves or grades or equipment or anything of any particular kind in order to fully meet that demand, it may anticipate it by year by year taking from its operating expenses and putting into a particular fund money to meet that improvement to be made at the expiration of ten years?—A. Yes, sir.

Q. Is there any other way in which that could be met by making the improvements now or at the present time and distributing the payments for it over the period of ten years?—A. I understand that the commission's rules will permit the spreading of the cost of work over a period of years, after application has been first made to the commission and its assent obtained.

Q. Then there are two ways in which to anticipate such depreciation: One by making the improvement at present and distributing the payment for it over a period of ten years or more with the consent of the commission; and the other is to accumulate it during a period of ten years or more, and then make the improvement after the accumulation has taken place?—A. I should say there is one way to anticipate it. There are two ways to take care of it.

Q. That is a proper correction; I accept the amendment. Do you regard that provision as a reasonable rule?—A. Personally, yes, sir.

Q. What is the practice upon your road? The practice is now, of course, to comply with the rule as all railroads do?—A. Yes, sir.

Q. But prior to the adoption in 1909, did you have a practice with reference to it?—A. Prior to 1909 we handled it both ways. There were some cases where charges were made to operating expense, and other cases where they were not. We were gradually growing into a proper rule.

Q. What was the development in your practice?—A. The development in our practice, of course, is what the commission now requires.

Q. Do you regard that as the proper method to be finally adopted by the railroad?—A. Yes.

Mr. NEEDHAM. I think that is all.

Cross examination by Mr. Wickwire:

Q. How long have you been in the service of the Great Northern?—A. The Great Northern and its predecessor, the Manitoba Company, nearly 25 years.

Q. You are a member of the Association of American Railway Accountants?—A. I am.

Q. And have been a member of the so-called committee of twenty-five?—A. I was for the first three years, I think.

Q. And you were a member of that committee of twenty-five in the year 1907, were you not?—A. Yes.

Q. And you were also a member of the subcommittee which drafted the tentative classification which was presented at the Buffalo conference in 1907, were you not?—A. I was.

Q. You, yourself, drafted and prepared that tentative classification, did you not?—A. No.

Q. Are you sure about that?—A. I am sure I did not prepare the one that was submitted and acted upon. That was the work of the subcommittee.

Q. Do you mean that you were not the author of the classification in its ultimate form, but that you prepared the tentative draft which was used by the committee? A. It was understood that each member of the subcommittee was to come to the meeting with a tentative draft. Several members had such drafts. It so happened that some of them were not get-at-able, and I happened to have a draft that was used by the members of the subcommittee, and after they had corrected it and revised it the result was submitted to the whole committee.

Q. So that in reality you prepared the draft that was used?—A. I prepared the draft that was used by the subcommittee.

Q. And that draft, as you understand it, was then printed and presented to the committee? A. That is, the subcommittee's revision was printed and submitted to the entire committee of twenty-five.

Q. The Buffalo conference lasted two days, did it not? A. I do not recall. I think I was there longer than two days.

Q. You were there with the subcommittee for a little time prior to the assembling of the committee of twenty-five, were you not?—A. Yes, sir.

Q. And the committee was in session for two days, was it not?—A. I could not say. I think so.

Q. Is it not a fact that the classification which was presented to the committee had never been submitted to the members of the committee other than the subcommittee until they arrived at Buffalo?—A. Yes, sir.

Q. It was printed and was just ready to hand to the members of the subcommittee on their arrival there?—A. That is my recollection, sir.

Q. The members of the committee of twenty-five, I mean—A. Yes.

Q. So that only two days were allowed for consideration of that tentative classification by the members of that committee?—A. That is, at that time.

Q. They had no opportunity to make any prior examination or study of that tentative classification?—A. I think that is correct.

Q. You were a member of this association as the representative of the Great Northern?—A. Yes, sir.

Q. And it was your duty to protect, as far as you could, the interest of your company, I suppose?—A. I did not so understand it.

Q. Did you understand that you were not the representative of the company?—A. I understood that I was called in as an expert, to be of any assistance to the Interstate Commerce Commission I could.

Q. But the company was interested, was it not, in the promulgation of regulations?—A. The company was interested in having proper regulations promulgated.

Q. And the company's interest was taken care of by you?—A. I should not so consider it.

Q. Who did take care of the company's interest?—A. Naturally I protected the company's interest if I saw anything wrong, but in proper classifications the question of the company's interest did not come in. All the company wanted was what was right.

Q. That is understood; but the company had no other representative than yourself in the committee or in the association?—A. It

and other representatives in the association, but no other representative on the committee.

Q. In respect of the regulations of the commission which are in controversy here, Mr. Lutz stated yesterday that the purpose of the provision that charges of this character to operating expenses, representing so-called abandoned property, might be spread over a term of years and that that was designed to prevent the working of hardship to railroads in some instances. Does that coincide with your view? A. I really am not competent to testify as to what the commission had in mind when it put that provision in the classification.

Q. In your judgment, would it be applicable but for the necessity of providing for some such situation? A. It seems to be a very reasonable proposition.

Q. You can understand, can you not, that but for that proposition, cases of hardship might arise? A. I think so, yes, sir.

Q. Those cases of hardship would be of what character? A. I think the rules have something to say about "if the inclusion of expenses in any one year would distort the showing for that year," or something of that kind.

Q. I think the phrase is "unduly burden." A. That means the same thing, but the idea, as I understand, was to prevent these sudden jumps up and down in the operating expenses and marked changes in ratios, and things of that kind.

Q. The effect of violent changes in the net operating expense as shown in the company's accounts might be disastrous, might it not, to the corporation? A. That depends upon whether they were explained or not.

Q. If unexplained, they might be disastrous? A. Yes, but I can not imagine any company omitting in its annual report to its stockholders to explain the reason for a large increase or marked decrease in its expenses.

Q. Would the burdening of the accounts, in case the accounts were unduly burdened, and the consequent failure of the corporation to pay its dividend, depress the price of that stock in the market?

A. I think that depends to some extent upon whether it was explained or not, and upon what its dividend history had been before that time.

Q. But if that policy were continued for any length of time and the road which had previously paid dividends was rendered unable to pay dividends, would not that seriously affect the stock? A. It probably would depreciate the stock somewhat.

Q. And might thereby also injure the credit of the corporation?

A. I do not think it would necessarily injure the credit of the corporation, no. If the corporation in its reports explains that its actual operating expenses were a certain amount, that under the rules of the commission it had been required to include in operating expenses the cost of certain improvements to the property, and consequently the remainder was not sufficient to warrant the paying of dividends, it seems to me that instead of injuring the credit of the company it would improve it, because it would show that the equity behind the bonds was constantly increasing and the security was better than it had been before.

Q. Then if the equity behind the bonds has increased by virtue of this improvement, and there has been an enhancement of the value of

the property, will you tell me, please, what justification there is for charging it to operating expenses?—A. I do not see that it differs at all. You have an improvement which costs a certain amount of money. That is covered, or a portion of it is charged to capital account and a portion of it is charged to operating expense. The property is increased or made more valuable by the carrying on of the improvements, and the credit of the company is enhanced, it seems to me, as its earning capacity is increased or as its property becomes the more valuable. But the charge to operating expense is simply charging the cost of what you might call replacement or renewal. It is charging the portion of the cost of the new line which takes the place of some other line. The new line, when it is completed, may be more valuable than the old line.

Q. You assume that these improvements of this character will substantially enhance the value of the property?—Your prior answer assumed that, did it not?—A. Yes, because I should not assume any railway company would make these changes unless they were to derive some benefit from them.

Q. What is your definition of "betterments and additions?"—

A. I can not recall the text of the commission's classification.

Q. I am asking you as an accountant, and not with reference to any regulation. A. Anything that better, the condition or adds to the property.

Q. Has a corporation a right to better or improve its property?—

A. What do you mean?

Q. Has a corporation the right to spend its money to improve its property?—A. So I understand, yes.

Q. Is that betterment or improvement an accretion to the capital of the company?—A. Sometimes, yes; and sometimes, no.

Q. If a corporation adds to its property or improves its property by, we will say, a reduction of its grades, is that improvement?—

A. It is improvement in the physical character of the property, yes, or.

Q. And as such it is chargeable to capital account?—A. Not entirely.

Q. What do you mean by "not entirely?"—A. In the case of a change of grade, they had a grade before. They have reduced it. The cost of reducing the grade or the cost of adding something which, added to what already had been done, will equal the cost of the new work, is an improvement to the property.

Q. Then the added cost of putting the property upon a reduced grade is the measure of that improvement, is it not?—A. The measure in dollars and cents of the proper charge to capital account, yes.

Q. When a corporation uses its capital funds, raised either from the sale of its stock or its bonds, for the improvement of its property, and does improve its property in an amount equal to the cost of the improvement, is there any justification for charging that expenditure or any part of it to operating expenses?—A. I do not think the source from which the money is derived has anything whatever to do with the basis for charging out the expenditure.

Q. But my question was whether under those circumstances any part of the cost of that improvement was chargeable to operating expenses?—A. Possibly I do not understand your question, but I

understood you to say if money had been raised on capital account, was it proper to charge the expenditure of that money to operating expenses or practically any other account than capital account. Is that it?

Q. Yes. — A. I do not think the fact that money has been raised on capital account, as you call it, has any bearing whatever upon the account to which the expenditure of the money should be charged.

Q. If it has been raised as capital and has been spent from that fund and has improved the property in an amount equal to the cost of the expenditure, is not that a proper charge to the capital account?

A. You assume that expenditure has improved the property to the amount of the expenditure?

Q. Exactly. — A. I assume that in the case of a change of line it has not improved the property to the total amount of the expenditure.

Q. Accepting my assumption and the testimony in this case is undisputed that that assumption is correct — will you state whether that expenditure is not chargeable to the capital account?

Mr. SEYMOUR. I object to that, your honor, as it assumes what is not the fact in this case. There is no undisputed fact in this case that the cost of the property equals the total expenditure, because they have deducted from it abandoned property. In making an improvement like this, or any other improvement, there are two items, one is the actual cash paid out, and the other is the value of property which has been abandoned as a part of that improvement, as a part of the program. There are two items to be disposed of independently, one, under the rules, is disposed of by going, so far as the balance is concerned, to capital account. The other is disposed of by going to operating expenses.

The COURT. What is that assumption — that this improvement was worth all it cost?

Mr. WICKWIRE. Yes; that the property after the improvement had advanced in value in an amount at least equal to the expenditure.

Mr. SEYMOUR. But value is one thing; cost is another.

The COURT. I think I will overrule the objection.

Mr. WICKWIRE. Read the question, Mr. Reporter.

The REPORTER (reading):

Accepting my assumption and the testimony in this case is undisputed that that assumption is correct — will you state whether that expenditure is not chargeable to the capital account?

The WITNESS. If the money has been expended for something which actually adds to the cost of the property complete, then I think it should be charged to capital account — the cost of the property as a completed property or as it stands.

By Mr. WICKWIRE:

Q. You mean after the finishing of the improvement? — A. I mean after taking into consideration what you had before and what you have now.

Q. You stated upon direct examination that the property account should only cover items which are now in actual use. Do you lay that down as an invariable rule, without any exception? — A. Possibly I can best explain that by giving my theory of railroad accounts and what a railroad is.

Q. Go ahead.—A. I do not see any difference between a railroad and any manufacturing institution. The railroad is engaged in manufacturing transportation. Like any first-class manufacturing institution, its property account on its books should represent what it has, what it has in case it was to be liquidated, upon which it would realize; and it is the duty of the railroad, like any manufacturing institution, to provide against the deterioration and obsolescence of its plant by making the proper charges to its expense account as it goes along.

Q. Do you lay that proposition down as an invariable rule, without exception?—A. As a proper rule, I think, for the operation and accounting for railways; yes, sir.

Q. Do you know of any exception to that rule as stated?—A. Personally, I do not.

Q. Taking the case of the surveys of a railroad, assuming that there are five different surveys made before the road is constructed, and that only one survey is used and the others are abandoned, are those other surveys now in use?—A. Yes. It was necessary to make those five surveys before they could determine the one on which to build.

Q. Will a physical inventory of property disclose those abandoned surveys?—A. Yes; they will, with proper explanation, and disclose it to the proper engineer.

Q. You mean that a physical inventory will reveal it if some one looks upon the books of the company and finds the item there?—A. Finds the item there and it has a proper explanation.

Q. Then the physical inventory is not in that case of what a man will find in going along the road, but some expenditure in respect to some other matter which is only now revealed upon the books?—A. Yes.

Q. Taking the case of an embankment constructed during the period of operation and before construction is completed, the engineers ascertain circumstances making it necessary or desirable to abandon that embankment and to build an embankment at some other place, carrying the line. Will you state whether or not the cost of that first embankment is a capital expenditure?—A. It is charged to construction; yes, sir.

Q. And is part of the capital account?—A. And it is part of the cost of construction of the road.

Q. You would not charge out the abandoned embankment?—A. You would not, because you have no operating expenses at that time to charge it to. You are assuming the road is under construction, I believe?

Q. Yes.—A. And not in operation?

Q. Yes; not in operation. Is it your understanding that many roads are what may be termed temporary structures?—A. You mean they are not built to what they finally hope to come to?

Q. Yes.—A. Yes.

Q. Conditions generally in a new country are such, are they not, that it is not practicable to build them in what you might call a permanent or finally completed state of efficiency at the commencement?—A. It would not be sensible to do it.

Q. Neither would it be possible to finance the enterprise in many cases, would it?—A. Probably not.

Q. If the road is constructed in this temporary form and is used for ten or fifteen years and is then improved, the first road was in a way necessary in order that the developed road in its improved state might come into being, was it not?—A. The first road was necessary to develop the country so as to warrant the second road, I suppose you mean?

Q. Yes.—A. Yes.

Q. Then there are in the development of that road various expenditures to be made from time to time in order to bring it to its final state of efficiency?—A. Yes, sir.

Q. And the expenditure for those improvements is a capital charge, is it not?—A. Not entirely.

Q. As a general proposition they are capital expenditures for the improvement of the property?—A. I could not say that is correct. That is altogether too general.

Q. I will make it a little more specific. Suppose a road is built at a maximum ruling grade of one per cent, and that some years later, with the development of the country and the increase of traffic, it becomes desirable, in order to handle the traffic economically and in order to meet competition, to reduce the grade to a maximum of five-tenths of one per cent, and the company proceeds to make these changes upon its original right of way. The expense of such improvement is a capital charge, is it not?—A. You are excluding those incidental expenses referred to yesterday?

Q. Yes; there might be some incidental operating expenses, but excluding those and assuming I am speaking now just of the cost of making the improvement, what is your answer?—A. When you say "right of way," you do not mean right of way the full one hundred feet? You mean the center of the line, the track?

Q. I mean upon the roadbed.—A. That, under the rule, would be charged to improvement.

Q. Is that proper, as a matter of accounting, irrespective of the rule of the commission?—A. I think so, because the changing of the grade requires the lowering of the summits or the raising of the fills, and requires the doing of additional grading, and the cost of that additional grading is a proper construction account, and that cost, added to the cost of the original construction, would give the cost of reproducing the present grade line at the time.

Q. Assuming that in certain portions of the line, as in this case, it is found that the desired grades can be secured by slight deviations from the original right of way to adjacent ground; that there will be large economy in securing the desired grade in that manner; that the efficiency of the line by the use of these new locations will be equal to the efficiency of the railroad if the grade reductions were made upon the original roadbed; and assuming, as is set forth in the petition, that these improvements would cost about six hundred thousand dollars if made on the new location; that the estimated replacement cost of the portion of the line upon which the track originally rested is four hundred thousand dollars; how, as a matter of proper accounting, would you dispose of those expenditures?—A. The cost of the new line is \$600,000, and the cost of the old line or reproducing the old line to be abandoned, \$400,000?

Q. Yes, eliminating the matter of salvage. A. There would be \$200,000 chargeable to improvement and \$400,000 chargeable to expense, if I have understood your question correctly.

Q. So that if this improvement had been effected vertically making, we will say, a change of grade of about 50 feet, you would charge it all to capital expenditure and pay for it and finance it out of the capital fund; but if the improvement to attain the same end were made by a relocation 50 feet to one side laterally at the same expense, you then would charge only one third of the expenditure to capital and would impose the remaining two thirds upon operating expenses? A. Answering your question specifically, yes. But it seems to me there are a good many other things to be taken into consideration.

Q. Do you regard regulations which logically and necessarily produce this result as sound and reasonable? A. I do, yes, as an accounting regulation; but these accounting regulations presuppose certain amount of intelligence upon the part of the reporting carrier in doing its work.

Q. Do you mean to imply that there is any lack of intelligence exhibited in making this relocation upon the adjacent territory, instead of going down on the original right of way? A. No; I mean there would be lack of intelligence upon the carrier if it went down 50 feet on its present right of way and spent \$1,200,000, when it could accomplish the same result by expending \$600,000 on a different location.

Q. And for the exercise of that sound judgment, you think it proper that the carrier should be penalized by having a charge of \$400,000 imposed upon its operating expense? A. I do not consider the charging of that \$400,000 to operating expense would penalize it at all.

Q. You think it should be charged there, do you? A. I do, absolutely.

Q. How did you state that your company handled matters of this kind prior to the regulation of the commission? Will you amplify that somewhat? A. We handled some changes of the line precisely in the way the rules now require them to be handled. I think there were other changes, back a good many years ago, that were handled differently. I think that this thing is something that has been gradually growing into approved practice.

Q. When the charges of this character were made, not to operating expense but to capital account, did you regard that as proper and legitimate?—A. I can not recall personally of when any charges of that kind were made that were not charged in this way. I was asked about practices of the company, and I tried to give it according to my recollection, but personally I do not recall any line changes where the entire cost of the work has been charged to improvements or construction.

Q. Do you recall a case in which a considerable portion of it has been so charged?—A. No; because I have not charged my mind with these expenditures extending over a period of a good many years. I could not say offhand how any one particular item had been charged.

Q. When that was done, as you state—you state the practice of your corporation has been to treat these items in both ways—d



you consider that when they were treated as capital expenditures it was sound accounting? —A. Undoubtedly, at the time.

Q. You considered that your corporation had the right to treat such expenditures as a capital expenditure? —A. Undoubtedly, at the time they were charged.

Q. So that if these regulations had not been promulgated, and reverting to the case as to which I have just interrogated you, had these changes been made by a relocation at an expenditure of \$600,000 and had \$100,000 been the estimated replacement cost of the prior roadway, you would then, prior to these regulations, have felt perfectly justified in charging the entire amount of the \$600,000 to property account, if you had wished to? —A. I think you are stating that a little differently than you did your question. You state I would have had the right to charge it. If these regulations were not in effect there is no question but what the complainant in this case would have a right to charge the expenditure any way it saw fit. Whether the charge was justified at all by proper accounting is another question.

Q. Is it not your opinion that that would have been proper accounting at that time? —A. Not theoretically proper accounting; no.

Q. You stated a moment ago that when you had treated items in that way, when they had been so treated in the practice of your railroad, you regarded it as sound accounting. No; I said I had the right to do it, or the company had the right to do it.

Q. Do you regard it as sound accounting? —A. I did not know as much about accounting probably then as I hope I do now.

Q. Do you regard that as unsound accounting? —A. I consider it, in view of my present knowledge and what I hope I have learned in a few years, improper accounting to duplicate charges on your books or to charge on your books something that you do not have.

Q. You think, then, that your prior practice in that regard was erroneous? —A. I do.

Q. In this case funds have been raised from the issue of bonds which provide that a certain portion of the bonds may be sold and that the proceeds may be used solely for the purpose of making improvements upon the company's railroad. An expenditure has already been made from the proceeds of those bonds. Under the facts of this case, previously referred to and set forth in the petition, and assuming that the replacement cost of the road as formerly used was \$100,000, will you state how that matter is to be treated? —A. I do not know that I quite understand you. You say the money to make this improvement was raised from the issue of bonds?

Q. Yes. —A. And the mortgage provides that the proceeds of the bonds should be used entirely in paying the cost of improvements?

Q. Yes. —A. Does it specify the character of improvements or does it specify changes on the line and matters of that kind?

Q. Yes. —A. It specifies improvements in the way of reduced grades and changes of line. —A. The mortgage specifies that the money is to be used to pay the cost of reducing grades, including line changes necessary?

Q. Yes. —A. Is that the idea?

Q. Yes. —A. And the money has already been expended?

Q. Yes. —A. I do not think that cuts any ice at all with the charges on the books.

Q. I ask you how you would treat it?—A. I should treat it precisely as the regulations call for it. I should charge \$400,000 to operating expense and \$200,000 to improvements.

Q. What is the situation with regard to the mortgage?—A. You simply comply with the terms of the mortgage. The money has been spent for the items that the mortgage raised the money for.

Q. Has it? It has been spent, if the regulations of the commission are correct and if the reports which the officials are required to make are truthful, to the extent of only \$200,000 out of the \$600,000 for improvements, and the other \$400,000 for operating expense.—A. I do not agree with you.

Q. Why?—A. Because the mortgage raised a certain amount of money to be spent in improving the property and by changes of line or reducing grades. The money has been spent for that purpose. The covenant of the mortgage has been complied with. The mortgage did not provide the money was to be spent for only such improvements as, under the classifications with reference to additions and betterments of the Interstate Commerce Commission, could be charged to additions and betterments, did it?

Q. Then you have upon your balance sheet \$600,000 of bonds outstanding, have you not?—A. Yes, sir.

Q. What can you write upon the other side of your balance sheet as an accretion to your property, representing that \$600,000?—A. You have only added your \$200,000.

Q. I see. So your balance sheet will assert to the world that you have spent \$600,000 in securing only \$200,000 worth of improvements?—A. No, it will not; not necessarily, at all.

Q. Why not?—A. You have a great many things on your balance sheet that do not show in your property account. You have a good deal of capital on your balance sheet that may not show, of necessity, in your capital account.

Q. I am not asking about a great many other things. I am asking what will be the items on the balance sheet with respect to this matter. How will it be reflected upon your balance sheet? Will there be more than the two items I have mentioned, namely, upon the one side \$600,000, and upon the other side \$200,000?—A. You will have your issue of bonds of \$600,000 on one side, and \$600,000 cash on the other side.

Q. Yes, and that has been spent. A. That has been spent, and you get \$200,000, and the rest of it is somewhere else. Your property account is increased.

Q. It is not in the property account?—A. No.

Q. The \$400,000?—A. No.

Q. It has gone in operating expense, has it not?—A. It has been charged to operating expense.

Q. It has gone in operating expense?—A. It has been charged to operating expense.

Q. Has it gone into operating expense account?—A. A do not understand your question when you say "has it gone into."

Q. I want to know if the other \$400,000 has gone into operating expense. A. The other \$400,000 has gone to pay that portion of the cost of the work which, under the rules, is chargeable to operating expense.

Q. Do you mean then that the money has not gone into operating expense?—A. I do not quite understand that.

Q. Where has that money gone? For what has it been expended?—A. It has been expended for this change of line. The full \$600,000 has been expended for change of line.

Q. Please tell me whether it has been spent for improvement of property or whether it has been spent to pay operating expenses.—

A. The money has been spent to make the change of line which has improved the physical condition of the property. The cost of that change of line or the cost of that improvement has been divided, \$200,000 to what you call capital account and \$400,000 to what you call operating expense account, or partially operating expense and partially to deferred assets, to be spread over several years.

Q. The net result upon your balance sheet is a property item of only \$200,000, and a debit item representing this bonded indebtedness of \$600,000, is it not?—A. You mean a credit item representing the bonded indebtedness of \$600,000?

Q. That is what I mean.—A. And an increase of property account or increase in cost of road of \$200,000?

Q. That is correct.—A. That will be the final result, unless you carry some of the \$400,000 into suspense and spread it over a series of future years.

Q. Do you regard such a balance sheet as truthfully reflecting the condition of the company?—A. Yes. It shows the cost of the road in its existing condition, and it shows capital that may be outstanding.

Q. Now, if instead of making these improvements upon the adjacent territory they had been made upon the original roadbed, what entries would you then make in your balance sheet?—A. You are assuming, I suppose, that the cost was \$1,200,000 of the old roadbed?

Q. Yes.—A. And that you issued \$1,200,000 securities?

Q. Yes.—A. You would have \$1,200,000 securities on the credit side of the balance sheet, and you would have figures of \$1,200,000 on the property account of the debit side.

Q. Under those circumstances you would have an accretion to your property account equal to the increase in your total bonded indebtedness, would you not?—A. Yes.

Q. And in the latter case there would be no charge whatever to operating expenses?—A. That is, in the twelve hundred thousand dollar case?

Q. Yes.—A. No.

Q. Do you think that would be an accurate representation?—A. Yes.

Q. Of the situation?—A. Yes.

Q. Now, let us assume that the expense to put it on the right of way was \$600,000, in order to make a comparison with the other case.—A. That is, \$600,000 instead of \$1,200,000?

Q. Yes. Now, in that case you would have an accretion to your property of \$600,000. In the other case, previously stated, you would have an accretion of only \$200,000; is not that true?—A. In both cases you would have an increase in capital of \$600,000. In one case—

Q. In both cases would you have an increase in capital?—A. You are assuming, as I understand it, that you issued bonds in both cases?

Q. Yes.—A. In both cases \$600,000?

Q. Yes.—A. That was your assumption, as I understood it.

Q. Yes. — A. Then, in both cases there would be an increase in your bonds of \$600,000. Now, in one case, as I understand you, there would be an increase in the cost of property of \$200,000 and in the other case there would be an increase in the cost of property of \$600,000. Is that correct?

Q. Yes. That is where it lands you? — A. That is where it lands you however you do the work, whether in the present location or by a change of line.

Q. You understand that is where it lands you, although it is undisputed that the result of this improvement adds the same amount of value with respect to efficiency to the railroads, whether it is made by one means or by the other. — A. The same amount of value?

Q. Yes. — A. As to efficiency?

Q. Yes. — A. Yes; but not the same reproduction cost.

Mr. Wickwire. That is all.

Redirect examination by Mr. NEEDHAM.

Q. Assuming that \$1,200,000 had been realized, as stated in this case, upon the sale of bonds, to what account would that money go first? — A. It would go into cash account.

Q. If \$600,000 of it was expended upon the main line for an improvement, without any abandonments and exclusive of the charges which are incidental and chargeable to operating expenses, where would that \$600,000 be charged? — A. To cost of property.

Q. To cost of property? — A. Yes.

Q. Where would the balance of the cash appear in the final balance sheet of the year? — A. In the cash account.

Q. Suppose, now, that the \$600,000 was expended upon this case upon parts of new right of way, and the abandonments, to say nothing of salvage, amounted to \$400,000, as was suggested, \$400,000 chargeable to operating expenses and \$200,000 to property account, where would the balance then be represented in the final balance sheet of the year? — A. You are assuming an issue of \$600,000 security?

Q. \$1,200,000. — A. \$1,200,000?

Q. The same; yes. — A. Yes; as I understand it, \$600,000 was expended by actual additions to the property and \$600,000 for line changes.

Q. Now I am stating to you, — In the first case, you said, if made up on the main line and \$600,000 was expended, the balance of the cash, which would be \$600,000, would be represented in the final statement in cash? — A. Yes.

Q. In the cash account? — A. Yes.

Q. Now, if that \$600,000 was expended for an improvement partly upon the old line and partly upon the new, and the abandonments amounted to \$400,000, as has been suggested, and the \$400,000 is charged on the books to operating expenses and \$200,000 to property account, where would the balance of the \$600,000 be? — A. There would not be any balance. You have spent \$600,000, as I understand?

Q. Out of the \$1,200,000. — A. But you have \$600,000 cash. If your question presupposes the expending of \$600,000, of course you have \$600,000 only in the cash.

Q. That would still remain in the cash unexpended? — A. Yes.

Q. In what account would the amount expended be reflected in the balance sheet—that is, the \$600,000 expended? A. The \$600,000 expended would be finally reflected in the cost of the property and in net profit and loss.

Q. You were asked whether or not any road was completed until had reached the final state of efficiency. Does any road ever reach a final state of efficiency? A. I do not think so.

Q. It is constantly making changes to meet new conditions and new demands and new traffic, is it not? A. Yes, sir.

Q. When is it considered complete for the purpose of responding to the accounting system? A. I do not know as I quite understand that question.

Q. Perhaps it is a little obscure. When is it complete for the purpose of responding to the accounting system, so far as operations are concerned? A. I do not understand that, so far as the accounting system is concerned, a road is ever completed, because you start

Q. I am responding to it. I do not say completed; but when does it begin to make its operating accounts and report? A. Well, when the original construction is completed.

Q. When it is ready for operation? A. When it is open for operation.

Q. And from that time on it is a road required to account for both operation and for additions and betterments? A. Yes; and for operation and any extensions that are built.

Q. You have been asked on cross-examination whether it be reasonable to burden the expense account in cases where such a burden would result in the company being unable to meet interest or dividend charges. Is that the result of bookkeeping, or is it the result of business policy? A. Why, it seems to me that would be the result of business policy, because the management would have an opportunity, by looking ahead, of providing a fund which would make these charges to operating expense unnecessary—that is, lump the charges in one year.

Q. In view of what you call reasonable accounting, would you say that a company, properly managed, would undertake improvements which would result in charging to operating expense items sufficient to absolutely wipe out its net balance of revenue? A. There might be times when it would be good policy to do even that.

Q. It is, however, a question of business policy pure and simple, is it not? A. It is a question of policy.

Q. And it does not affect the question of the reasonableness or unreasonableness of bookkeeping or accounting? A. It does not affect the general principles of accounting, as I understand it.

Q. You were asked about the consideration, I think, of the report of the subcommittee at Buffalo. Had the subject of these accounts—the classification of these accounts—been under consideration before at other meetings? A. At other meetings of the subcommittee; yes. I can not say whether the matter had been mentioned in meetings of the full committee. I do not recall. Probably it had.

Q. At that meeting, when the matter under consideration here, the charge of abandoned property was passed upon, do you recollect when it was passed upon, at what time in the proceedings? A. I think toward the end of the meeting. I think that most of the com-

mittee rather lost interest in the classification, and the matter was tentatively dropped until the classification could be submitted to their executives.

Q. With reference to this fifth item, do you know when that was considered?—A. I do not recall.

Q. Now, with reference to the reference of this to the executives, what was the purpose of that move?—A. As I recall it now, the larger portion of the accounting officers did not feel at liberty to speak for their managements in respect to this matter of abandoned property, and it was submitted to the executives so that they could see whether they favored the idea or whether they disapproved of it.

Q. Wherein and how would the interests of the executives differ from the interests of the expert accountants, looking at it purely from the standpoint of the expert accountant?—A. Well, the expert accountant, looking at it from purely an accounting basis, would give his opinion regardless of the effect it might have upon the policy or finances or anything else of his own road; while the executive, looking at it from the point of view of his own road, would have his showing, you might say, in mind, or his company's showing.

Q. Practically, the objection to the rules with reference to the treatment of abandoned property is that it does not allow the accumulation in property account of property which has, in fact, been abandoned, and cannot be inventoried?—A. I think so.

Q. The difference in policy would be simply that some executives want their showing and the others do not?—A. I would rather not express an opinion upon what the executives may show or may not show.

Q. As an executive officer, I thought you might answer that question. However, I will withdraw it. A. I have already given the policy of our road.

Q. That is quite sufficient. There is one other question that I had in mind. I want to call attention to the questions put to you with reference to the disposition of \$1,200,000 borrowed for the purpose of making these improvements, and taking the last illustration, where the improvement was made for \$600,000 off the right of way in part, and \$400,000 is charged to operating expenses, and \$200,000 to property. Treating that as a single item, you said that there would be \$600,000 in the cash account remaining. Is it not a fact that before charging up the operating expenses there would be \$400,000 of revenue also represented in the cash; that is to say, in the statement of that account through operating expenses as against operating revenues, would the result be affected, and if so, how?—A. Operating revenues have nothing to do with the cash. You issued \$1,200,000 securities, and got \$1,200,000 cash, we will assume. Now, you expend \$600,000 on property, on the right of way, according to your first assumption. That takes \$600,000 out of the cash, and adds \$600,000 to the cost of the property.

Q. That balances that item?—A. That balances that item. You have \$1,200,000 on one side, and \$600,000 of property and \$600,000 of cash on the other side.

Q. That is true, but how about your operating revenues and your operating expenses in the one place and in the other? How are they affected?—A. I do not understand that the operating revenues come in in any way shape or form.

Q. The revenues go into cash, do they not?—A. The revenues go into cash, of course, but that has nothing to do with the cash from these bonds.

Q. You are keeping that as a separate account?—A. No; but you are dealing with the proceeds of \$1,200,000 of bonds in the first instance. Now, you are taking in other cash.

Q. Yes; I am taking in the revenue. I want to know what effect there would be in one case different from the effect in the other case where the whole \$600,000 was charged to capital account. Now, how would that change the account of revenue and expenses?—A. The inclusion of the \$400,000 in operating expenses would necessarily reduce the amount of the net operating revenue, and so be finally reflected, as I said, in your profit and loss account.

Q. Where would the cash be?—A. The cash would be spent. You would spend \$600,000 for the improvement, and you have charged \$200,000 off to property.

Q. You could not spend the cash twice, could you?—A. Certainly not, sir.

Q. That is what I do not understand and would like to have that explained. You have charged \$400,000 to operating expenses?—A. I think I begin to see now what you have in mind.

Q. I hope to make it clear. You must excuse me, I am not an accountant. In the one case, if you kept the account separately and charged the \$600,000 to property account, that would balance, your net revenues would be \$400,000, would they not?—A. Yes.

Q. Now, if you charge part of that to operating expenses, your net revenues are reduced on your books, but you can not spend the cash twice.—A. I understand now what you are getting at.

Q. I wish you would explain it. A. That is, if you had not spent \$400,000, or assuming that this work cost \$400,000—

Q. No; I am assuming that it cost \$600,000, and \$400,000 of it is abandoned property. A. I understand what you mean now. You are assuming the work cost \$600,000?

Q. Yes.—A. And \$200,000 of it is charged to property account and \$400,000 to operating expenses?

Q. Yes.—A. If you had not raised this money by the sale of securities and had charged the \$400,000 to operating expenses, you would have paid for it out of your operating revenue.

Q. There being so much less cash.—A. The cash on hand would represent the net operating revenues, or the difference between the gross revenues and the operating expenses; but if you paid this \$400,000 out of the money that was raised by the sale of securities, you would have in your cash the \$400,000 of operating revenue.

Q. Well, assuming that there was, without the charge in revenue account \$400,000 of profit; there would be \$400,000 of cash representing the balance between operating revenue and operating expenses. Now, if you paid for it out of the money borrowed in fact and charged the \$400,000 to operating expenses, the books would show no net revenue, but the fact would be that you would have \$400,000 in your cash?—A. Yes, sir.

Q. That is what I was trying to get at. So that, in that case, as the result of the bookkeeping of the two items you would have, as a matter of fact, \$600,000 of the \$1,200,000 left in cash, and you would have \$400,000 additional cash in the revenue account?—A. Yes, sir.

Q. And that would be reflected, of course, in the accounts to the credit of the company?—A. Yes; that would be on your balance sheet as one of your assets.

Q. Yes. With such a result as that could the credit of the company be seriously impaired?—A. Well, it would require a proper explanation in the report, of course.

Q. With proper explanation, of course. Would you consider as improper, in any sense, the use of the funds realized from the sale of bonds?—A. I should not consider it improper when the mortgage specifies that the proceeds of the bonds were to be used for purposes of that nature.

Mr. WICKWIRE. How many of the stockholders do you think would understand this explanation?

Mr. NEEDHAM. He has refused to impeach the officers. I do not know that he would want to impeach the stockholders.

Mr. DENISON. Tell us who they are first.

By Mr. NEEDHAM:

Q. I have, perhaps, one more question and then I am through, although possibly Mr. Denison may have some question that he wants to ask. A. I do not think it is any worse than some of the explanations that are now made.

Q. What is meant by the phrase or general expression "making the public pay for the abandoned property"?—A. I do not think I ever heard that expression, sir.

Q. Haven't you? I thought I put you on the stand as an expert?—A. I am sorry if you have been disillusioned, but I do not think I heard that expression.

Q. Nothing like it?—A. I think I understand what you mean.

Q. Well, that is sufficient. A. But you asked me a specific question. I think the idea you have in mind is that the public, having had the benefit of the use of the property, should contribute toward its cost or toward its ultimate replacement with something better.

Q. That is the idea. Well, how is that done?—A. The only way that can be done is at the present time under the present rules, seems to me, by including the expense in operating expenses.

Q. How does it result, then, that the public are supposed to make a contribution to these improvements?—A. If the operating expenses, going back to my first illustration, are kept the same as those of a manufacturing plant, the contribution each year in the way of rates is sufficient to pay the expenses of that year, and the expenses of that year are sufficient not only to cover operations and maintenance of that year, but to provide for the future and all future replacements.

Q. Therefore, a little higher charge would be warranted for the goods produced than would be warranted if all of such depreciation was charged to capital account and capitalized?—A. Of course, if it is charged to capital account and capitalized somebody has to pay the interest on that capital.

Q. Aside from the interest upon the capital—A. By being charged to your expense, and your depreciation or your reserve accounts credited then the replacements are made without any charge of additional capital and no additional charge for interest.



Q. In one case, then, the price of the product, whatever it may be, is maintained at a standard sufficient to pay for the depreciation during the year or the period of years when it is charged to operating expenses?—A. I think so.

Q. In the other case it is capitalized and the rates or the prices are maintained sufficiently high to pay the interest or return upon the additional capital for all time?—A. Ye, sir.

Mr. NEEDHAM. That is all.

By Mr. DENISON:

Q. You were a member of the committee of twenty-five at the time of the Buffalo meeting?—A. Yes, sir.

Q. You were not a member at the time of the Atlantic City meeting?—A. Oh, yes.

Q. You were still a member?—A. Yes, sir.

Q. Were you a member of the subcommittee at the time of the Buffalo meeting?—A. Yes.

Q. And also at the time of the Atlantic City meeting?—A. Yes, sir.

Q. Were there any changes in the personnel of the committee of twenty-five between those two meetings?—A. I think so.

Q. Do you know what the changes were?—A. I could not testify on that. I have not kept track of the members of the committee.

Q. Was there a substantial change in the personnel?—A. I could not say, sir.

Mr. DENISON. That is all.

Recross examination by Mr. WICKWIRE:

Q. That committee changes in respect of five members every year, does it not?—A. I think it does.

Q. That is, five men retire and five new men go on each year?

A. Well, five new members are appointed. They may not be new men.

Q. Well, I mean new members of the committee?—A. They are new members, but they may not be new men. They might have been former members reappointed.

Q. Allusion has been made to the policy of your company. Now, your company is in the class of railroad corporations in this country which is not likely to be embarrassed in any way or subject to any hardship by the operation of the regulations in question, is it not?

A. I hope not.

Q. Well, you know it is not, do you not?—A. I can not say what may happen in the future.

Q. Well, the corporation is a prosperous one?—A. Yes.

Q. To a large degree, is it not?—A. Yes, sir.

Q. And is able to pay and has paid for many years an eight per cent dividend?—A. No, sir; seven.

Q. A six per cent dividend?—A. Seven per cent.

Q. The corporation has had enormous surpluses at its disposal?—A. I could not say enormous; no.

Q. Well, the corporation was able, within a few years, to issue a very substantial dividend to its stockholders?—A. Issued a dividend?

Q. Yes; a special dividend in the way of ore property?—A. That had nothing to do with its earnings from operation.

Q. I say, the corporation had this property, and owned it a few years ago.

Mr. NEEDHAM. What is that question? Is he talking about your property [addressing the witness]?

The WITNESS. He is talking about our iron-ore property.

Mr. NEEDHAM. I do not see what that has to do with this case or this question. I simply referred to the practice for the purpose of showing that it was not a new proposition. Now, I do not think on cross-examination they should go into the details of other matters in the conduct of this railway. I did not introduce it here for the purpose of disclosing that.

The COURT. I do not suppose the financial condition of these ore roads is in issue here.

Mr. WICKWIRE. No; except in this way: Counsel has brought out on redirect examination what the policy of the Great Northern Railroad has been.

Mr. NEEDHAM. In reference to their abandoned property.

Mr. WICKWIRE. Yes; in reference to the issues of this case, I think it is proper in explanation of that, and in explanation of the attitude of the witness, to show that these regulations will not operate injuriously in respect to their corporation, and may, in fact, be very favorable. I think it is proper in testing the interest of this witness.

The COURT. Well, it may be as to the general proposition that it is a prosperous road and is in good financial condition, but I do not see any necessity for going into particulars.

Mr. WICKWIRE. I will not go into great detail, your honor.

By Mr. WICKWIRE:

Q. Your road also, in addition to being prosperous, has favorable grades as compared with other lines running from the Mississippi Valley to the coast?—A. On account of the grade reductions we have been making in recent years the grades are very favorable; yes.

Q. Do you not regard the grades upon your road as more favorable than they are upon any other of the lines running from the Mississippi Valley to the Pacific coast?—A. I think they are more favorable than the neighboring roads; yes, sir.

Q. Yes; and other roads may, in order to compete and handle their traffic efficiently, have more occasion to make grade reductions than your road?—A. Yes.

Q. And these particular regulations in question will probably have a greater influence upon the management of these other companies than upon the management of your company?—A. I would not say any greater influence upon the management—possibly a greater influence on the accounts.

Q. I mean that the operation of these accounts will have an effect to a greater extent upon these other lines than upon your own?—A. I do not think that these accounts will have any greater effect upon the management of any other line than they would on ours; no, sir.

Q. May they not apply in a greater number of cases in that property, in view of your superior grades?—A. If you mean that other roads may make more grade reductions than we do, and consequently have more often occasions to charge a portion of that work to operating expenses than we, I would say yes.

Q. That answers the question. You were asked upon direct examination as to the matter of rates. Now, the effect of these regu-

tations in question may be distinctly beneficial, may they not, to a very strong and prosperous road in enabling it to keep down its apparent net earnings and thereby to assist it in maintaining its rates?—A. Considering the fact that I have just testified to, that our line would probably have fewer charges to make to operating expenses on account of changes of line than most others, I do not see how it is going to assist us to keep up our operating expenses.

Q. I am not asking especially with reference to your road now, but am referring to prosperous railroads generally.—A. I did not differentiate. You had been asking about our line a moment ago, and I thought you were still talking about it.

Q. No; the last question was general, if the reporter will kindly read it.

The Reporter (reading):

You were asked upon direct examination as to the matter of rates. Now, the effect of these regulations in question may be distinctly beneficial, may they not, on a very strong and prosperous road in enabling it to keep down its apparent net earnings and thereby to assist it in maintaining its rates?

A. I do not recall having been asked anything about rates on redirect examination. I was asked about operating revenues and about his \$100,000 business, but nothing in regard to rates, as I recall it.

Q. Oh, yes.—A. Possibly, but in a different way.

Q. It is in the record. What is your answer to the question?—A. I do not understand that I was asked anything about rates on redirect examination.

Mr. NEEDHAM. What is that question? Will you please read it?

The Reporter (reading):

You were asked upon direct examination as to the matter of rates. Now, the effect of these regulations in question may be distinctly beneficial, may they not, on a very strong and prosperous road in enabling it to keep down its apparent net earnings and thereby to assist it in maintaining its rates?

After informal discussion.

Mr. WICKWIRE. Please read the question.

The reporter thereupon read the question as previously recorded.

The WITNESS. Do you wish me to answer the question in view of the explanation that has been given? If you do, I will.

Mr. WICKWIRE. Yes; I would like an answer.

A. I should think that the effect of these regulations would be to help the weaker lines more than it would the stronger lines. The fact that a line is a strong line presupposes that it has made its grade reductions and its improvements, and is a machine of great efficiency. If it is an efficient machine, it is making large net revenues, we will not, and, of course, the larger its net revenues, the greater the danger of attack; while if the road is a weak road and has not changed its grades, reduced its grades, or gotten into a state of good efficiency, these rules permit it to do a good deal of that work and charge the cost to expenses, and so make the people pay for it, as I understand the question put to me on the other side.

By Mr. WICKWIRE:

Q. You mean, then, by reason of the regulations of this commission, we are justified in increasing the present rates on our road in order to get this additional money; is that the idea?—A. I do not

say that, because I do not know what your rates are or what your returns are, but so it is.

Q. Assuming now that they are fair, you think the effect of the regulations, under the circumstances of this case, warrant the company in increasing the rates?

MR. NEEDHAM. I object to that question. That is not the question involved here. One of the elements of the theory of the charge into operating expenses is that there would not likely be rate reductions. It does not follow at all that, because the company, as a matter of business policy, has made an improvement which involves the charging of abandoned property into the operating expense account to the extent of actually wiping out the net revenue for a given year, that would warrant them in raising all rates, because the rates may be in themselves entirely reasonable. The questions are not the same, and, practically, to ask him whether this move on the part of the Kansas City Southern would warrant your road in raising its rate is entirely an improper question.

THE COURT. I think I will sustain the objection. We do not want to go into the rate question.

MR. WICKWIRE. If your honor please, I am not endeavoring to go into the rate question any further than to explain the suggestion that has been brought out by counsel for the commission. If I correctly understood him, he brought out that matter from the witness. He inquired, and the witness answered the questions, which evolved the theory that the public would pay for this improvement by the means here involved in this case. Now, if the public is to pay for it, it can only pay for it through rates, and I wanted to know of the mode, operandi, of how this theory of the witness would be worked out. I wanted to know if it was practicable; I wanted to know if it was substantial; and I think I may be able to show to your honor that it is an utterly unsubstantial and untenable theory.

THE COURT. I do not think the question would elicit the information you want, then.

MR. WICKWIRE. Well, I wanted to know if he meant in his previous answer to be understood as stating that, in order to pay for this improvement, such rates might be imposed upon the public as would enable the corporation to get payment for this improvement out of the public.

MR. NEEDHAM. You have changed your question.

THE COURT. I do not think that question is before us; neither do I think the witness is competent or called upon to show what the corporation may do or may not do.

MR. WICKWIRE. As I understand it, this is one of the theories which he has advanced.

THE COURT. Read the question.

The question referred to was read by the reporter, as follows:

Q. Assuming now that they are fair, do you think that the effect of regulations, under the circumstances of this case, warrants the company in increasing the rates?

THE COURT. The objection is sustained.

By MR. WICKWIRE:

Q. Will you please explain how this company can get paid for this improvement from the public by and through the operation of

these regulations?—A. That is putting the same question in another way, is it not?

MR. NEEDHAM. I object to that question. It is simply the same question made in a different form.

THE COURT. I sustain the objection.

By MR. WICKWIRE:

Q. Without particular reference to this corporation, and as a general proposition, will you state how the public may be made to pay for improvements of the character involved in this case?—A. Do you wish an individual theory?

Q. I want an elucidation of the theory which has been suggested.—

A. It has always been my impression that a railroad company should be permitted to establish such rates as will enable it to earn its operating expenses, which would include earnings such as I have mentioned, taxes, and a fair return upon the value of its property devoted to transportation. Now, if the rates are made on that basis, and these items are included in operating expenses, the rates would be sufficiently high to cover these items.

Q. Now, you understand, do you not, that the conditions of competition to which a railroad company is subjected might render it entirely impracticable for it to make any increase in its rates adequate to pay for an improvement of this kind?—A. That would be the unfortunate situation of such a company; yes.

Q. As a matter of fact, do you know of very many railroads throughout this country that are in a position to increase their rates and retain their business, under the existing competitive conditions?—A. Do you mean single companies—single individual companies?

Q. Yes.—A. Of course, there is no one company that can increase its rates when it is brought in competition with another. All the companies have to act together in a matter of that kind.

Q. Well, assuming a corporation having a line of some seven or eight hundred miles and having five or six competitors with respect to the through business between its termini, whether it be your judgment that, with respect to any of that through business, it would be able to make any increase of its rates under these competitive conditions?—A. I rather think that all of the roads engaged in that business would be very glad, indeed, if they could all raise their rates.

Q. But do you think it would be feasible for an individual railroad company to increase its rates?—A. Not by itself.

Q. In that case it would not be possible, upon this theory, to make the public pay for this improvement, would it?—A. This theory, as I understand it, has been worked out by the commission for all of the railroads in the country and does not single out any one railroad, either strong or weak roads, but they made the classification to take care of all the roads.

Q. Yes; but now answer my question. The conditions which I have indicated may often arise in which it will be impracticable for any rates to be so regulated as to give the company payment from the public for that improvement; is not that true?—A. Any one particular road, possibly, for any one improvement, but I still think that all the roads in the country would have the benefit from a regulation of this kind.

Q. And if this railroad, in individual cases, is quite unable to get payment for this improvement out of the public, then it is lost to the stockholders, is it not?—A. It is their unfortunate investment; yes.

Q. And the unfortunate investment might arise in connection with an improvement of their property?—A. Not at all.

Q. The case involved here is the case of an improvement of the line through a reduction of grade?—A. Yes; and possibly they were unfortunate in going into the company. That is what I mean.

MR. DENISON. Or in losing the property abandoned.

By MR. WICKWIRE:

Q. In other words, if I understand it, and reverting once more to the illustration of improvements made changing the line and improvements made off the line, do you think that regulations which permit the stockholders to enter in capital account the expense of a grade reduction of the line and which deny the right to make that charge if the improvement is made upon adjacent ground, are reasonable, notwithstanding the fact that if the improvement is made in the latter case the stockholders may lose all benefit from the improvement?—A. As I said before, I think the regulations were made for all the roads in the country without regard to any particular one, be it weak or strong. On that basis it must be made on broad, general grounds and in connection with correct accounting principles. I think the regulations are reasonable even though in some one case it causes loss.

Q. Even though it might, in an individual case, wreck a railroad?—A. I do not think it is possible to wreck a railroad.

Q. Assuming that to be the effect of it, you still think it reasonable?—A. I do not think that has any bearing upon the question.

MR. NEPHEW. I object to that assumption.

By MR. WICKWIRE:

Q. Assuming that a railroad had for five or ten years been enabled to pay its preferred-stock dividend of four per cent, and that the volume of business and net returns upon its operations were the same during the ensuing five years, and assuming that the company determined to improve its road by revisions of grade upon adjacent locations, and that the expenditures necessary for that account would, according to the regulations of the commission, absorb the entire net earnings of the road during that ensuing five years leaving no distribution whatever—no money distributable to the preferred-stock holders during that period, would you regard those regulations as fair to the preferred-stock holders?—A. I think your case is somewhat exaggerated, but even under that illustration the regulations might be fair, and it might be for the interest of the preferred-stock holders to have the work done; that is, the future advantages might be sufficient to compensate for the present loss.

Q. And as between two railroads identically situated in point of capitalization, one of which made its reductions of grade upon the original right of way and the other of which made its reductions of grade upon immediately adjacent territory, you think the regulations are perfectly proper which would permit the payment of dividend continuously during the period of five years to the stockholders of one company, and that with respect to the stockholders of the corporation making its improvement upon the adjacent territory

not a dollar of dividends should be paid? Do you think those regulations are reasonable?—A. I think the regulations are reasonable. The question of dividends and all that sort of thing has nothing to do with the regulations.

Q. Do you think that would be fair treatment to preferred-stock holders?—A. I think, as I stated before, the regulations had to be made for all the roads together. They are reasonable as of and in themselves; whether they affect one road adversely or not is a misfortune of that particular road.

Q. Do you think it is proper that the preferred-stock holders of a corporation which makes its grade reductions on adjacent territory should be prevented, under those circumstances, from receiving any dividends?—A. I think you put a rather absurd question there.

Q. There is nothing absurd about it; it is vitally practicable and imminent.—A. I have answered the question, that I think the regulations are reasonable, and if the road is so unfortunately situated as to have to forego some dividends on account of compliance with those regulations, it does not change their reasonableness, because the regulations must cover all the roads and can not be made to cover any one particular unfortunate condition.

Q. You think it would be an unfortunate condition for the management of a railroad company, in the exercise of sound judgment and correct engineering principles, to make their grade reductions upon adjacent territory when they might be made upon the same ground?—A. Not at all. I do not know whether I understand you, I would like to have that read.

The REPOUNDER (reading):

Q. You think it would be an unfortunate condition for the management of a railroad company, in the exercise of sound judgment and correct engineering principles, to make their grade reductions upon adjacent territory when they might be made upon the same ground?

By Mr. WICKWIRE:

Q. (Continuing.) Upon the ground of the original right of way?—A. Now, exactly what do you mean by that? Possibly I have not sensed it right.

Q. What I mean is, you have stated that you think the regulations are reasonable, notwithstanding the fact that there might be unfortunate cases in which they would operate injuriously. Now, I ask you if this is one of the misfortunes to which you allude, namely, that the management of a railroad has determined, in the exercise of sound judgment, to make grade improvements upon adjacent territory which could have been made on a right of way? Is that one of the misfortunes that you had in mind?—A. I should not call that a misfortune.

Q. But, nevertheless, you think it is perfectly proper for the railroad company, under those circumstances, to be put in the position where it can not pay its preferred dividends?—A. Here is the position, as I understand it: I do not know as I got it right: It might be very much better for the preferred-stock holders to have \$600,000 expended to make line changes on adjacent property and \$400,000 of that saved by giving up the dividends on the preferred stock for a series of years, than to have \$1,200,000 expended and \$1,200,000 bonded debt, about \$600,000 additional bonded debt, paying the preferred-stock dividend and having changes made on the existing line.

Q. Is not that rather a question of policy than anything else? A. I have already testified, I think, it is a question of policy where line change should be made.

Q. And whether a corporation shall apply its net earnings to the improvement of the property or to disbursements to the stockholders is a question of policy, is it not? A. Absolutely.

Q. Now, where would there be any opportunity for policy to have any operation in this case if the regulations of the commission make such provisions that there are no net earnings in any way applicable to dividends? A. Well, policy would determine whether they would make any line changes at all or not, and if they made no line changes, there would be no charge to operating expenses and no necessity for withdrawing dividends.

The Court: Will you finish with this witness shortly?

Mr. NEPHEW: I want to ask him one or two questions when they finish with the witness on this point. I think I can get through in a few minutes. Are you through?

Mr. WICKWIRE: Just one more question.

By Mr. WICKWIRE:

Q. May not the ultimate effect of the operation of these regulations be the deferring by a good many railroad companies of the making of improvements which otherwise might be made? A. I don't know.

Q. Well, don't you think that is a very logical operation? A. I should not think so, no, sir.

Q. If a railroad corporation is not permitted to make these payments for improvements of this character entirely out of the issue of its bonds, and is simply limited to financing them out of the net earnings, it is limited to its net earnings, is it not? A. I think I testified a little while ago that the rules, in my estimation, did not limit financing at all. That was something for the company to arrange, and the fact that they raised money by bonds and spent it on improvements, and that, under the commission's rulings, a portion of the cost of those improvements had to be charged to operating expenses, had nothing to do with each other. Possibly I am not as good a witness on the future effect of these regulations as some one else would be, because you said a little while ago that I am connected with a prosperous road.

Q. I did not say so. You said so. A. In reply to your question.

Q. Now, let us understand just one matter further: When these improvements involved in this case had been paid for out of the proceeds of bonds, and then when, afterwards, in compliance with the requirements of the commission, they are, we will say, charged to operating expenses to the amount of \$400,000, then that sum of \$400,000 is actually taken out of the operating expenses, is it not? A. No; it is actually added to operating expenses.

Q. Added to the operating expenses? A. Yes.

Q. Well, I mean it is actually taken out of the net revenues or net earnings? A. Well, do you mean the money, or do you mean in stating the accounts?

Q. I mean in stating the accounts; and, in fact, it must be done.

A. In stating the accounts, the money is added to the operating ex-



penses, and so is taken out in stating the income account. It is taken out of the earnings.

Q. Then, when it is taken out of the earnings it is returned to the bond account, is it not? A. No. When it is taken out of the earnings it belongs to the company; it is in its treasury.

Q. Yes; but if \$500,000 have first been taken from the proceeds of bonds for the purpose of improving the road, and it is found that only \$200,000 of improvement has been made, and that only \$200,000 may be entered in the property account for the improvement, then, in order to balance the account, \$300,000 must be taken out of the net earnings and restored to the bond account, must it not? A. No; you have \$400,000 in your treasury, and you can use this to pay off additional improvement.

Q. Do you wish to be understood as stating that, under these circumstances, it would not be necessary to return \$400,000 to the trustee of the mortgage? A. Why, certainly.

Q. Why? A. Because the mortgage does not usually specify a line change here, a line change there, and a line change somewhere else. A mortgage is usually rather general in its terms, and provides for certain additions and betterments, specifying them by line changes, grade reductions, or something of that kind. Now, instead of spending \$500,000, the money raised by the sale of bonds, you only have to expend on certain line changes \$200,000 and pay out the remaining \$300,000 from your earnings. You have \$400,000 of money need in the sale of bonds that you could devote to other improvements covered by that mortgage.

Q. That is, \$400,000 left on hand out of the proceeds of \$500,000 of bonds? A. Yes.

Q. Your statement is that that amount of money is left as proceeds of the bonds? A. Yes, say \$400,000 left either as proceeds of the bonds or as out of earnings, whichever way you wish to call it.

Q. Must it not go back to the bond account? A. No.

Q. Suppose an improvement of this kind was made, and that you, as auditor of the road, were required to make a certificate to the trustee of the mortgage for the purpose of obtaining the bonds; we will suppose the money has been loaned from some other fund temporarily, and finally \$400,000 had been paid from operating revenue and \$200,000 had been paid for the improvement in addition, and it is necessary for you now to get bonds from the trustee, what quantity of bonds could you obtain on your certificate under those circumstances, with the limitation previously mentioned in the mortgage, that the money can be applied only to improvements? A. You are stating the question differently from what was stated on the other side, which brought out this answer. The question asked by the other side was if the \$500,000 had been paid for temporarily out of the proceeds from the sale of bonds. That means the bonds are sold and the money is in the treasury before it is expended. Now you bring a different proposition. That money is expended from some temporary source, and after the expenditure has been completed, make a certificate and draw bonds, isn't it?

Q. Yes.—A. It depends entirely on the terms of the mortgage.

Q. If the mortgage provides that the proceeds can be used only for improvements? A. They could not draw that \$500,000 if the mortgage did not specifically provide for only such improvements,

the cost of which could be charged to improvements under the commission's classification.

Q. Then, you mean that improvements to the amount of \$600,000 had been made upon this property? A. It depends entirely upon the terms of your mortgage. If your mortgage specified that the money is to be used for line changes, you can, under the provision of that mortgage, draw the entire cost of the line change. I think it depends entirely upon the covenants of the mortgage.

Q. The covenants of the mortgage provide that the money can be used only in the paying for improvements? A. Does it specify or limit the improvements to such improvements as are covered by the commission's classification?

Q. It does not. A. Then the commission's classification has nothing whatever to do with the certificate prepared and filed by the trustee. It does not enter into this particular question, as I see it.

Q. In other words, you mean that a particular transaction may be reported on the principles of sound accounting to the trustee of the mortgage as an improvement to the property of \$600,000, and as the Interstate Commerce Commission it is only possible to assert that the property has been improved to the amount of \$600,000? A. I have not said anything of the kind.

Mr. NEEDHAM: There is nothing of that kind. It is improved to the extent of \$600,000. It seems to me, your honor, that the question of accounting to the trustee of the mortgage is entirely outside of the inquiry here. I have not objected to it because I did not want to be put in the position of assuming that this rule interfered with any correct statement of fact here to the trustee of the bonds or to the stockholders. The whole transaction can be reported fully in either case, and accurately. The whole money is expended. It is a question of how the changes should be entered.

The COURT: I think we may assume that.

Mr. WICKWIRE: That is all.

Mr. NEEDHAM: May I ask one or two questions?

By Mr. NEEDHAM:

Q. With reference to the question of policy, your attention has been called to it. Whether a company will enter upon such a grade improvement or not depends upon the probabilities of benefits to the company, either in reducing the expense of operation or in securing increased traffic, and usually both? A. Yes.

Q. In the report of Mr. Burt in this particular case, which has been offered in evidence, I find he makes a statement, "Estimated saving per annum from operations on a reduced grade, \$154,000." Now, that was the estimate that was before the board of directors with reference to the probable reduction of operating expenses, and it is upon such an item as that that the board acts, is it not? A. Let me see if I understand that. That expenditure of \$600,000 for grade changes would result in the reduction of \$154,000 in operating expenses?

Q. That is what he says. A. Of course, they would act on that.

Q. Now, in addition to that, as he terms it here, "fortified itself against the aggressive development of its powerful neighbors and competitors, and in order that it may be able to handle at a profit the great volume of agricultural products offering at Kansas City."

and may rapidly develop its coal and other low grade tonnage resources?—that has reference to an increase in the volume of business?—A. The volume of traffic; yes.

Q. And in determining the question of policy, they would take that into consideration?—A. They would.

Q. Now, if they judged correctly, and it resulted in this reduction in operation, and this increase in business, of course, at the same rates, it would increase the net revenues very largely?—A. Very materially.

Mr. NEEDHAM. That is all from this witness, if your honor please, far as we are concerned.

The COURT. We will take a recess until 2 o'clock.

Mr. NEEDHAM. The witness would like to be excused.

Whereupon, at 12:45 o'clock p. m., a recess was taken until 2 o'clock p. m.

#### AFTER RECESS.

Met at 2:00 o'clock p. m., pursuant to taking a recess.

Mr. WICKWIRE. If your honor please, I was going to suggest to the court the question of whether we would be able to finish up the taking of testimony this week. I understand from counsel on the other side the probability is they will finish with at least two of their remaining three witnesses this afternoon, and that in all likelihood it could finish with one session, probably, to-morrow morning. I do not know whether it is the practice of the court to sit on Saturdays or not. If it is, we will be glad to finish, because we have witnesses from a very considerable distance and it would save us from coming back again if we could wind up the taking of the testimony at this time.

The COURT. Do you think you can finish in the morning?

Mr. WICKWIRE. I think we can, unless the examination to-day takes longer than we think it will.

Mr. NEEDHAM. We have simply Mr. Bailey to go on the stand, and he will cover practically the same ground as the former witness, as I expect. I do not know whether you are through with your examination of Mr. Lutz or not.

Mr. WICKWIRE. No.

Mr. NEEDHAM. Then, there is the cross-examination of Mr. Lutz concluded, and then the taking of the testimony of Mr. Adams, which I think it probable that we can get through this afternoon with our business, except Mr. Adams, and put him on in the morning.

The COURT. Will there be any rebuttal?

Mr. WICKWIRE. I do not know that we will have any. I am not sure, but if we do it will be short.

The COURT. I will sit to-morrow morning, and we can commence ten o'clock if it will and you any.

Mr. WICKWIRE. Very well; thank you.

W. E. BAILEY, a witness called by and on behalf of the respondents, having been first duly sworn, testified as follows:

Direct examination by Mr. NEEDHAM:

Q. State your name and residence to the reporter. A. W. E. Bailey, Chicago, Illinois.

7559—12—21

Q. What is your occupation at the present time? A. I am the general auditor of the Atchison, Topeka & Santa Fe Railway.

Q. How long have you occupied that position? A. About seven years.

Q. What was your occupation before that? A. I was assistant general auditor for a period of about five years.

Q. Of the same road? A. The same road.

Q. Before that? State generally what your occupations have been in connection with railroading. A. I commenced work with the Atchison Company in 1884, and have been connected with the old company and the new company continuously since that time in the railway accounting work, with the exception of approximately a year and a half that I was in the operating department.

Q. You have been present, Mr. Bailey, and heard the testimony in this case, and know the subjects in controversy? A. I think so.

Q. You are familiar with the rules of the Interstate Commerce Commission with regard especially to the charging and accounting of abandoned property? A. Yes, sir.

Q. You have occasion to operate under that rule in connection with your road? A. Yes, sir.

Q. And have since the adoption of the rule? A. Yes, sir.

Q. Before the adoption of the rule you had some policy with reference to the same subject, I assume? Yes, sir.

Q. That is, it is an item that has to be dealt with continuously in a railroad system? A. Yes, sir.

Q. I will ask you first with reference to the rule regarding the charging out or crediting out, perhaps I should say, from the property account of the abandoned property? A. In my opinion as an accountant?

Q. If you please. A. A railway plant deteriorates from abandonment the same way as it does from wear and tear and the action of the elements.

Q. Would you include in the depreciation, in addition to wear and tear, sudden accidents? A. Yes, sir.

Q. The results of sudden accidents? A. Yes, sir.

Q. Would you include in depreciation, as one of these causes, inadequacy of equipment or road or both? A. Yes, sir.

Q. To meet the traffic, the demands of the public? A. You mean abandonment because the roadway or the structure or the plant was not adequate to do the work economically?

Q. Yes. A. Yes, sir.

Q. Will you state the reasons for your theory, as an accountant, for deducting or crediting to the property account the items of depreciation for the causes named? A. I think in railroad practice we should apply exactly the same business rules as apply to any other business, and obsolescence is an expense, and should be so treated.

Q. Is it your opinion that obsolescence and inadequacy should be treated as a current expense in each year so far as it is ascertainable? A. Theoretically, I should say so. As a practical proposition, I think that is an impossibility.

Q. When, then, would you treat a case of depreciation caused by inadequacy? A. The railway accountant has his problems to solve just the same as anyone else has, and one of the difficulties that we encounter is to determine absolutely and unqualifiedly what moment

the obsolescence takes place. As soon as that is determined, I should say that it is proper to write it into the account.

Q. Take the case of inadequacy of engines to handle increased loads, both increase in carload and increase in trainload. In order to meet the demands of a traffic upon the road, which was growing and expanding, it became necessary to abandon the engines then in use, when would you say that should be charged out?—A. With locomotives we have a little better experience than with most any class of material. We know from year to year that a certain amount of locomotives will go out of business for obsolescence. They may not go regularly, they may go spasmodically. Therefore we undertake to anticipate, and I believe that to be the proper procedure—the obsolescence of locomotives and cars, both freight and passenger.

Q. How do you anticipate it?—A. We get the best judgment of the mechanical department; it is discussed by the management, and we use all means we have at hand to get the very best out of it that we can.

Q. And reach a determination as to what shall be done?—A. Yes.

Q. How is that determination reflected in the accounts?—A. By spreading the charge over the life of the equipment.

Q. As a depreciation charge?—A. Yes, sir.

Q. As new and heavier engines and trainloads are put upon a road, the roadbed becomes inadequate, does it not?—A. Yes, sir.

Q. (Continuing.) To carry them? First, as to its bridges, perhaps, and, second, as to the roadbed itself—that is, the line road. Is that correct?—A. Not so much in the roadway, but probably the number of ties, the rail, the size of the rail, and those things.

Q. That is included in my question.—A. Then it would apply to both roadway and bridges.

Q. The inadequacy, then, of the railroad becomes imminent whenever the new equipment is to be placed upon it?—A. Yes, sir.

Q. So that you have to anticipate that?—A. Yes, sir.

Q. It is impossible to put on the new equipment of a heavier type, upon a road constructed for lighter equipment, is it not, with safety?—A. Yes, sir.

Q. So that the same cause which requires you to put on heavier engines also requires you to reconstruct your roadbed?—A. Yes, sir, and bridges.

Q. And bridges?—A. Yes, sir.

Q. Is that true with reference to the reductions of curves and grades?—A. I do not think it applies exactly to the reduction of curves or grades.

Q. To make the heavy equipment efficient; that is, to bring it to its maximum practical efficiency, is it not necessary to reduce the curves and the grades?—A. To get the efficiency out of any locomotive, regardless of size, the lower your grade line the more efficient the locomotive; but probably while you could operate a light locomotive economically over a high grade line it would hardly pay you to invest a considerable sum in a large locomotive to operate over the same line.

Q. After you have made these changes in equipment and in roadbed, roadway, and bridges, and secured heavier equipment and a more substantial and costly roadway or roadbed, have you changed

in that way the character of your road both as to its efficiency and as to its cost?—A. Yes, sir.

Q. In that process you have made expenditures which are properly chargeable to property account?—A. Yes, sir.

Q. If, however, in making those changes you have scrapped engines and cars that have become inadequate, and you have discarded or abandoned parts of the old line, those abandonments, whether of equipment or roadbed, are to be taken, as I understand you, from the property account?—A. Yes, sir.

Q. What is the purpose of that policy as distinct from the purpose of a policy that allows this wreckage to accumulate in the property account?—A. Will you read that, please?

Mr. WICKWIRE. I do not really understand that question, and I therefore object to it as immaterial.

Mr. NEEDHAM. It is very well illustrated in the cross-examination of Mr. Seger, where he said he would retain three lines of road, costing, less the salvage, \$130,000 per mile in the accounts, when the road actually in operation cost \$150,000\* and should be valued at \$150,000.\* I call that wreckage.

The COURT. The objection is overruled.

The pending question was repeated by the reporter as above recorded.

The WITNESS. As an accountant I consider that all abandoned property should be written out of the capital account.

By Mr. NEEDHAM:

Q. Can you state why?—A. I can not other than I think it is a good business practice and a practice that would be pursued by any good business concern regardless of whether it be a railroad or otherwise.

Q. Coming, now, to charging the abandoned property, less salvage, to operating expenses, will you give the reason for that?—A. The what?

Q. The charging of abandoned property, less salvage, to the operating expense account.—A. Because it is a depreciation, and depreciation goes to the operating expenses.

Q. Mr. Bailey, prior to the adoption of this rule by the Interstate Commerce Commission in 1909, what was the practice of your road in regard to this matter of charging out of the property account and into operating expenses the abandoned property?—A. It was similar to the present practice as promulgated by the commission, with the exception that we used prior to July 1, 1907, the original cost instead of the reproduction cost.

Q. Can you give as illustration any instances on your road where abandonment of roadway and bridges or a bridge took place and the disposition made of it, as an illustrative case?—A. We have been doing a great deal of that work in the last ten years, and we have a great many examples. While I do not handle all of the detail in connection with everything that happens over the line, I know in general of several cases.

Q. Just give one to illustrate the working of the practice.—A. We had a line of railway through what is known as the Moro Canyon, in New Mexico. It was built a great many years ago, and occasionally

\* Error in transcript. Should be \$50,000. See page 211.

we would have a washout in that piece of line. They might be some years apart, but we were inconvenienced occasionally by those washouts. As the traffic grew stronger from the California end of the line our difficulties became greater. It was finally decided to abandon that line in its entirety—I will not say in its entirety, but a large part of it—and go up on the side of the canyon and make the road-way up on the rocks, where it was not possible to wash out. In that case we followed the so-called abandonment theory of accounting.

Q. You charged the abandoned property, less salvage, to operating expenses?—A. Yes, sir.

Q. And took it out of, or credited it out of, the property account?—A. Yes, sir.

Mr. DENISON. This was prior to the promulgation of the rules?

Mr. NEEDHAM. In 1909.

The WITNESS. I am not so positive. I think the Moro Canyon property was prior to that. If that is not an example, we had others which were similar at that time.

Mr. NEEDHAM. That is all.

Cross-examination by Mr. WICKWIRE:

Q. Did you have another improvement which you made at what is known as the Belen Cut of a similar character?—A. Yes, sir.

Q. That was made prior to the promulgation of the commission's regulations?—A. Yes, sir.

Q. Will you state how much of expenditure was involved in that matter?—A. I can not undertake to give it to you in anything but round figures. That will probably answer your purpose. I should say you refer to the reduction of grade extending from Clovis, New Mexico, to Wellington, Kansas. My recollection is there was involved a total expenditure of some six million dollars, of which \$2,500,000 represented the abandoned line.

Q. What you might refer to as the cost or estimated value of the abandoned line?—A. Yes, less salvage.

Q. Less salvage?—A. Well, on those lines there was very little salvage, because there was not much on that line.

Q. What did you do with that amount of approximately \$2,500,000?—A. That work extended over a considerable period of time. It was done in connection with the building of a so-called cut-off, the Belen cut-off, for bringing freight around on a lighter line instead of passing it over the Glorieta and Raton Mountains. It took several years to complete that property, and during the time they were working more or less on this grade revision of the old line. We continued to apply the so-called rule of abandonments up to February, 1907.

Mr. DENISON. How long was that from the beginning?

The WITNESS. About two or three years. Our charges to renewals became then very drastic as the work was pushed along very rapidly, and it was decided that we would depart from our practice of charging the balance, which would have been an operating charge, to profit and loss. The commission were advised as to our change and our reasons for making the change at that time.

By Mr. WICKWIRE:

Q. How much did you charge to profit and loss?—A. I do not want to give you the exact figures, but out of the \$2,500,000 I should say that a little over one million was charged to profit and loss.

Q. And was not charged to operating expenses?—A. No, sir.

Q. Did you have charge of the keeping of the accounts at that time?—A. I did, sir.

Q. Were those charges made by you after consulting with the president of the railroad?—A. After consulting with the president of the railroad, after consulting with Mr. Dickinson, the head of the firm of Price, Waterhouse & Company, and after the matter was discussed in New York by the executive committee.

Q. At that time the regulations in question, which were first promulgated in 1909, as I understand it, relative to the classification of betterments and additions, had not been promulgated.—A. No, sir.

Q. Under the law you were at liberty to apply those according to the proper principles of accounting.—A. We felt that we were. We did not like to depart very much from our former practice without having some good reasons for it.

Q. But you felt that you had it within your discretion.—A. Oh, yes.

Q. (Continuing.) To make those charges in that way if you chose?—A. Yes, sir.

Q. In other words, that that was sound business practice.—A. It was legal, at least.

Q. Did you not regard it as sound business practice?—A. Personally I did not. I have tried to prevail upon our people to pull that back and put it into operating expense, since under the proposed rule we might prorate it, but our good president said it was a thing of the past and he thought he would permit it to remain that way.

Q. You would be satisfied now to have those items paid out of the net revenue and deducted from the returns which might otherwise be made to stockholders?—A. Will you please read that again: I want to be sure I understand it.

The pending question was repeated by the reporter as above recorded.

A. You mean deducted through addition to our operating expense?

Q. Yes.—A. I think that is sound accounting.

Q. With reference to the so-called inadequacy to meet the demand of increasing traffic, is it necessary in order to meet those conditions to have any abandonment whatever?—A. That would depend. I should say, entirely upon the most economical method of meeting such abandonments.

Q. If the traffic has so grown that it is not practicable to carry it all upon a one-track road, the inadequacy may be met, may it not, by constructing a double track?—A. Yes, sir.

Q. In that case there is no abandonment?—A. Yes, sir.

Q. All the expense necessary to build the second track is chargeable to property account.—A. Yes, sir.

Q. Assuming, however, that the management found it could accomplish the same ends, and that it would subserve all the requirements of the company, instead of making a second track, to reduce the grades upon the existing track, and thereby greatly to increase its efficiency, and that that change could be made in certain instances more economically by constructing the track upon immediately adjacent territory to the present roadway, is it your opinion that the entire expenditure necessarily incident to that improvement of the property is not chargeable to capital account, but that some portion



must be charged out from the capital account representing abandonment of property?—A. In my mind, in looking at this problem, there are really two features. First, your expenditure for your new line which represents so many dollars and cents for construction; the second is an adjustment in your capital account for the abandoned property. Practically, it results in charging to capital account the difference between the total cost of construction and the value to replace the abandoned property in kind.

Q. Assuming that two railroad corporations, having substantially similar conditions, determine to improve their roadway in the line of grade reduction, and that one of them adopts the method of making those grade reductions entirely upon its roadway; that the other adopts the plan of using some relocations, and that the result attained is equal in either case, do you see any reason in the nature of things why one railroad should charge off for abandonments and why the other should not?—A. I think that it is the best business policy to guard your capital account as against your operating expenses.

Q. Yes. You think it might be good policy to adopt that in one case, but do you think it is absolutely obligatory upon a corporation to do it?—A. From my viewpoint as an accountant I should say it was.

Q. That is based, is it not, upon the assumption that the railway plant has become inadequate?—Is that right?—A. Yes, sir.

Q. If that inadequacy is entirely cured by revisions upon the existing right of way, nothing need be charged off for that inadequacy, need it?—A. I should say yes; I should say your abandonments should be taken out of your property account.

Q. I have assumed that there is no abandonment.—A. Oh,

Q. Because the improvement is to be upon the existing right of way.—A. In both cases?

Q. No; in one case on that and in the other off it. Let me frame the question again, so that you will understand it. Suppose the inadequacy is simply inability to take care of an increased volume of business, and that the railroad company meets that inadequacy and cures it by a reduction of grades upon its existing right of way. Then there is nothing to abandon, is there, and nothing to be charged off?—A. No; not on number one.

Q. In the case of the same inadequacy, if the railroad concludes that it is more economical or more desirable for any reason to cure that inadequacy by the use of relocations, will you state why it is then obligatory upon the company to charge off something for abandonment when you have cured the inadequacy?—A. I will answer that by saying that railway accounting is not an exact science. In formulating rules, representing what I will call the best American practice, we must necessarily follow out certain lines. Having once formulated those rules, which we believe to represent the best American practice, then I should say we should adhere to those rules and not depart from them from time to time to meet individual cases.

Q. Even though some hardships might be worked?—A. Yes.

Q. In individual cases?—A. I do not think it is possible to write a rule that is going to fit all cases, and if we did not have a rule and stick to it we have no uniformity.

Q. You think the regulation then would be reasonable, although we will say in fifteen per cent of the cases it would work a hardship?—A. I think so.

Q. How would it be supposing it worked hardship in twenty-five per cent of the cases? Would it still be reasonable?—A. Yes.

Q. How about the result if it worked hardship in fifty per cent of cases?—A. You have got me on a dividing line now. I would have to flip a coin.

Q. Suppose we make it fifty-one per cent, if it will make it any easier for you.—A. I should say we would have to change the rule, and the best American practice would be upset.

Q. If the result of these hardships was to produce the insolvency of certain corporations, owing to their inability to finance their improvements, and their consequent inability to meet competition, you would still regard the regulations as reasonable?—A. I can not conceive of such a condition. I will say as a theoretical question that I would.

Q. You would still think them reasonable if they caused the insolvency of only forty-nine per cent of the railroads of the country?—A. I can not conceive that a good business rule which puts back into your property a sum of money out of earnings equal to the abandoned property, equal to the cost or replacement value of abandoned property, would ever weaken your credit.

Q. Suppose a railroad has only small earnings and has a fierce competition; that the only way in which it would be able to make revisions of its grades and thereby reduce expenses and meet competition, and to succeed, was through the use of relocations, and that those expenditures could not, under the regulations of the commission, be financed by an issue of bonds, and that if financed at all they must be financed through operating expenses, and assuming that the operating expenses are inadequate for that purpose, then the regulations would work some hardship upon that company, would they not?—A. I would prefer not to answer that as an accountant, but rather as an investor in railway property. I should say you had reached the danger zone there, and it was better for the stockholders to go down in their pockets and finance their own property and protect the investment they had without putting any more mortgage on top of it.

Q. If the stockholders refused to do that and the road was unable to raise money on its credit, then the company might go under by reason of its compliance with these regulations?—A. If the owner refused to protect his own property, I do not see there is anybody else interested other than the mortgage holder.

Q. You can understand that if a railroad corporation was in such a situation, physical and financial, that its only success could be attained through the issuance of bonds for improvements of this character, and that it had no operating revenues available for this purpose, that these regulations might cause it serious embarrassment?—A. I think so; yes; that goes without saying.

Q. Prior to these regulations it would have been perfectly lawful, as you understand it, for the corporation to have financed its necessary requirements by the issue of bonds, and to have paid the entire expense by an issue of bonds, without making a charge to operating

expenses?—A. My experience in that line is only limited of course to our own company.

Q. But I am asking you for your opinion as an accountant.—A. That would depend upon the conditions of the general mortgage indenture under which those mortgages were issued.

Q. I am asking you the question not so much as to the mortgage, but I am addressing my attention to the question of whether, prior to the promulgation of the commission's regulations, you could not regard it as within the power of the corporation, if it so chose, to finance its obligations, without making charges representing the abandonment, incidental abandonment, to operating expenses.—A. I should say no; and I would like to explain my answer by saying that I make it on advice given to me by our counsel on this very particular point.

Q. You mean, then, that you consider the action of your company in respect of the charges made for the improvement at the Belen Cut was unlawful?—A. That is not the question involved in your question, or the proposition involved in your question.

Q. I understood it was the same.—A. No; we never attempted to capitalize the abandoned property there. We charged up about a million and a half of it to operating expenses. Then, when it got so drastic it was giving us a pretty stiff operating ratio, we charged the balance of it to profit and loss, but it was never a question of attempting to capitalize the cost of that line except as to the amount it exceeded.

Q. I see.

MR. NEEDHAM. Nor did you leave it in the property account.

THE WITNESS. Nor did we leave it in the property account.

By MR. WICKWIRE:

Q. But you regarded it as lawful at that time to make a charge to your profit and loss account and not to precipitate that expenditure upon the operating income?—A. We did.

Q. Assuming that in the course of construction certain embankments were built and it was subsequently found desirable by the engineers to abandon that embankment and to construct and to use another prior to the commencement of operations on the road, to what account would the cost of the original embankment be chargeable?—A. It would remain in the account it was originally charged to.

Q. Which is the property account?—A. The property account.

Q. And of course the cost of the second embankment would also go into the same account?—A. Yes, sir.

Q. So that you would then have in your capital account a gross amount representing both embankments?—A. Yes, sir.

Q. Notwithstanding the fact that throughout the entire life of the road thereafter only one embankment was actually used?—A. That is one of the hazards of the construction.

Q. Assuming now that the cost of certain improvements made by relocations is \$600,000 and that the estimated replacement cost, excluding salvage, of the portion of the track no longer to be used is \$400,000, will you please state how you would charge those items?—

A. The ultimate result of the entries would be to charge to capital account \$200,000 and operating expenses \$400,000.

Q. Under the commission's regulations?—A. Yes, sir.

Q. If the improvement, the reduction of grade, was obtained upon the original right of way instead of upon relocations, how much would then be chargeable to those accounts?—A. No abandonments?

Q. No abandonments. A. \$600,000.

Q. Chargeable to property account?—A. Yes.

Q. And nothing chargeable to operating expenses?—A. Yes; nothing chargeable to operating expenses.

Q. What is your idea of whether the trustee of a mortgage which authorized the issuance of bonds to be used in the improvement of a railroad would certify and deliver \$600,000 of those bonds to the railroad company in respect of an improvement of this character if it were made upon relocations?

MR. NEEDHAM. I do not quite understand that. If it is intended to ask this witness what would legally be required, that is one thing. If he asks him whether he thinks it would be done—that is, whether the officers would do it or not—that is entirely a different thing. I do not see it is in controversy in this case. The whole subject as it is claimed involves simply the disposition of the abandonment accounts. It has been stated over and over again here that whether the company will involve itself in an enterprise that will charge to the operating expenses a given amount for abandoned property is a matter of policy, depending upon the prospective effect of such an improvement, and it has also been stated here over and over again that the use of funds realized upon the mortgage for the purpose of making such improvements is properly devoted to the improvement, although in the accounts to the Interstate Commerce Commission it appeared part of it to result in a charge to operating expenses because abandonments are required to be charged to operating expenses, that result showing itself in the cash account in each case. Whether the witness is of the opinion, as an accountant, that the trustee of a mortgage would certify bonds under such conditions I do not think is proper.

THE COURT. I think your objection is just; objection is sustained.

MR. WICKWIRE. I do not care to press the question. I will frame another.

By MR. WICKWIRE:

Q. Assuming the same situation which I cited above, how much money would be obtainable from the trustee of a mortgage in respect of this improvement made upon adjacent ground?

MR. NEEDHAM. I object to that. It involves the construction of a mortgage that is not before us.

THE COURT. No; we are getting away from this question at issue here, it seems to me. The objection is sustained.

By MR. WICKWIRE:

Q. Assuming that the railroad company has obtained from the mortgage and proceeds of bonds the sum of \$600,000, applicable to improvements, and assuming that these improvements are made in this manner upon adjacent locations, and assuming that all of this money has, in the first instance, been spent for that purpose, will you state how the accounts must ultimately stand and what must be done to conform to the regulations of the commission?—A. Following the entry from the sale of your bonds through?

Q. Yes.—A. Your bonds having been authenticated and sold, you would charge the cash account with \$600,000 and credit your bond account, assuming that you sold those at par.

Q. Yes.—A. \$600,000 would be credited to your bond account. That would be the first transaction.

Q. You would then have, if I may interrupt you, upon one side of your balance sheet \$600,000 in cash, and upon the other side you would have a liability of \$600,000 on the bonds?—A. Yes, sir. The second transaction would change your assets of cash into a property asset of \$200,000 charged to additions and betterments and \$400,000 charged to operating expenses.

Q. How much would you then have left in your property account as the representative of this property?—A. \$200,000.

Q. \$200,000 representing the cost of the improvement?—A. No; representing your investment, not the cost.

Q. Representing this improvement?—A. Your increased investment would be represented by \$200,000.

Q. Then you have, you say, an additional item of \$400,000 which is a debit to the profit and loss account?—A. That is the ultimate effect; yes, sir.

Q. In other words, if your corporation before this transaction had no surplus and no deficit, it would when this transaction was completed appear that it had a deficit of \$400,000?—A. Yes, sir.

Q. It would appear that the corporation had lost in some manner the entire \$400,000?—A. Yes, sir. Your profit and loss account would be in debit.

Q. That means a deficiency of assets?—A. Yes, sir; and it would be self-evident that that had been expended out of capital moneys. It would be plain on its face where the stuff came from.

Q. But if this improvement had been made upon the right of way, then you would not show in your balance sheet any deficit whatever?—A. No, sir.

Q. Were you present at the Buffalo conference?—A. Yes, sir.

Q. Do you recollect whether the so-called tentative classification which was prepared by the special committee was ready for the members of the committee of twenty-five when they arrived or some time later?—When did it become ready for their use?—A. I think I have rather a clear recollection of that, as I was a member of the special committee, but was unable to be present in Buffalo, owing to a business matter which detained me. My recollection is that we had one or two conferences of the special committee on the additions and betterments classification before the Buffalo meeting, and that the committee expected to meet on Monday and Tuesday of the week and complete its report to the main committee. Of course, being absent Monday and Tuesday, I do not know what those people did, but I know that—

Q. (Interrupting.) Then you are not advised upon the point. It was simply as to the time?—A. No.

Q. (Continuing.) When the paper was printed and ready for distribution to the committee of twenty-five?—A. I was there on Wednesday morning.

Q. Was that the last day?—A. No, that was the first day of the main meeting.

Q. The committee of twenty-five had a meeting for two days?—  
A. Yes, sir. I may not be correct as to the days, but my recollection is the special committee met on Monday and Tuesday, and that the committee of twenty-five met on Wednesday and Thursday. My recollection is now that the printer had not completed everything the boys had submitted to him the night before when we assembled Wednesday morning.

Q. And some time later during the period of two days, the printing of the tentative classification was finished and then submitted to the members?—A. My recollection is that we had a part of the printing done; some of the first proof sheets were brought to us and we worked along on those, and that they were delivered to us gradually. That is my recollection, although I may be wrong.

Mr. WICKWIRE. That is all.

Redirect examination by Mr. NEEDHAM:

Q. I want to refer to your answer in which you say there would be by certain accounting a deficit of \$400,000 in the profit and loss account at the end of the year.—A. \$400,000; yes.

Q. If \$600,000 had been borrowed upon bonds, or credit, for an improvement, and the \$600,000 had been expended for that improvement upon the right of way, there being no abandonments to charge out, that would balance the \$600,000 account?—A. Yes, sir.

Q. If you treated it by itself?—A. Yes, sir.

Q. Would it not?—A. Yes, sir.

Q. And it would carry into the property account \$600,000?—A. Yes, sir.

Q. If instead of doing that, only \$200,000 of that cash was used for the \$600,000 improvement, it would leave \$400,000 of cash in that account as cash, would it not?—A. Yes, sir; as cash.

Q. If it carried that \$400,000 to operating expenses, the net operating expense would be reduced that amount?—A. I do not just catch you on that. May I have it repeated?

Q. I will put it in the concrete, if you will allow me. Take the bond account, now, as a separate account. Charging cash with \$600,000 received from the sale of bonds, charging, you say, the whole \$600,000 improvement to that account would balance that account and leave nothing to go to profit and loss on either side. Is that true—in the way of cash?—A. Let me ask a question. You convert your cash into property expenditure of \$600,000, which is chargeable to additions and betterments?

Q. Yes. Then you balance that account.—A. You exhaust your cash and convert it into an additions and betterments charge of \$600,000.

Q. Which goes to the property account. Now suppose that your company—it has a good deal more, I know, but I am not used to dealing in large figures—supposing your company had a balance, a net revenue, of \$2,000,000. If none of that improvement had been charged to operating expenses, that would be represented in your cash as a balance of your revenues, would it not, as a net balance of your revenues?—A. Not as an actual thing, because you would have your assets and liabilities, but you can illustrate by saying it is a cash.

Q. Yes.—A. \$2,000,000 in cash and \$2,000,000 profit and loss—

Q. You have gotten ahead of me; I can not keep up with you. What I want to get at is the reflection of this \$400,000 as a cash item. If it is taken out of a net \$2,000,000 revenue received, it would leave the revenues \$1,600,000, would it not, instead of \$2,000,000?—A. Yes, sir; if it was expended in property operations.

Q. So that the balance would be \$1,600,000 instead of \$2,000,000 if you treated it separately by itself; and your \$600,000 account, in that case, would have a cash balance of \$400,000, would it not?—A. In other words, you are attempting to substitute cash in the treasury out of the earnings for the cash that was expended in the sale of bonds. Is that the point?

Q. Yes. I can not understand why the cash balance is not the same in both cases. I want to get at it. I want you to explain it. Assume at the end of the year, after balancing your accounts, you have a balance of \$2,000,000 net revenue from operating revenues—I understand it is all blended, but I want you to treat them separately.—A. I understand.

Q. You have \$2,000,000 in cash, provided the whole \$600,000 improvement has been charged to borrowed money. Suppose now instead of charging the full \$600,000 to the borrowed money account you only charge \$200,000 to that account and you charged \$400,000 to your operating expense account the result would be that your net revenues would be \$1,600,000 in that case, would they not?—A. You mean the surplus—the profit and loss?

Q. Yes; what I call net.—A. Your net earnings were \$2,000,000 and as against that—

Q. (Interrupting.) And if you put a charge in there you would have \$1,600,000?—A. In your surplus account; yes.

Q. To go to profit and loss, but in that event you would have \$400,000 in cash in this other account, would you not?—A. The reflection of your balance sheet in this case—

Q. Would not that be the fact?—A. As shown by your balance sheet. You can not separate cash when you get it into a cash account as between the cash that is derived from the sale of bonds and cash that is derived from the operation of your property.

Q. But I am separating it now for the purpose of showing it does not make a particle of difference which way you charge this so far as it is reflected in the profit and loss account, because if you—A. (Interrupting.) I can not agree with that.

Q. I know you can not, but I want to find out where I am wrong; that is all. If you take these two accounts and treat them separately—I know the difficulty of doing it—but if you do treat them separately you say, "Now, here is \$600,000 borrowed and I will keep that separate as cash of the company, and here is an improvement that cost us \$600,000, all of which is chargeable against that fund, and I charge it against the fund and balance it." Your net revenues that year are \$2,000,000 and you have it all in cash. You carry over therefore \$2,000,000 into the next year in some form, do you not; is not that a fact?—A. Yes; that is a fact.

Q. In some form you carry over \$2,000,000?—A. Yes, sir.

Q. Suppose instead of doing that you only charged \$200,000 to your borrowed money account and charged \$400,000 of it to your



operating expense account. You have reduced your item of \$2,000,000 to \$1,600,000, but you still have \$400,000 in cash in the other account, which makes your cash in hand at the end of the year precisely the same. Is not that it?—A. That makes your cash in hand?

Q. Yes.—A. Yes, sir.

Q. Just the same. So that so far as the assets of the company are concerned—I mean the visible assets, represented in this case in cash, they are the same whichever way you charge that item of \$400,000.

I mean the result is the same?—A. If I correctly understand your question your proposition is right.

Q. In determining business policy with reference to improvements of the kind under consideration the important consideration is whether or not the result of such improvements would be a reduction of operating expenses and an increase in the traffic, thus producing additional net income; is that correct?—A. That I should say in a large majority of cases is so. It might possibly be—

Q. (Interrupting.) What other consideration could enter into it? Well, I will put it in another way. Would a company, wisely managed, go into a large improvement involving considerable money unless it could see a good probability of reducing its operating expense or increasing the volume of its traffic, or both?—A. It might be necessary in certain cases to protect its earnings.

Q. That is to prevent depletion?—A. Yes; depletion.

Q. Yes; that is right. As a business proposition, and not as a matter of accounting, if a corporation was advised that to make an investment in changes that would amount to \$600,000 and that in making those changes it would have to charge \$400,000 of that to operating expenses it would save in net income per annum from operation \$154,020 would you say it would be good business policy to make that investment?—A. I should say that would be extremely good policy.

Q. If, in addition to that saving, the business management could see a large increase in its traffic, would that make it a still better business proposition?—A. Yes, sir.

Q. I think I will leave that illustration as it is. It is not, strictly speaking, this case. You referred to an improvement known as the Belen cut-off. That was prior to the adoption of the present rules of the commission, and as I understand you it was submitted to other officers by you and also to your executive committee as a proposition to depart in that case from your usual practice.—A. It was discussed with the president, who asked me if I would get the views of Mr. Dickinson, of the firm of Price, Waterhouse & Company.

Mr. WICKWIRE. I object to this on the ground it is immaterial.

Mr. NEEDHAM. You brought it out.

Mr. WICKWIRE. I did not ask him anything about getting the views of Price, Waterhouse & Company.

Mr. NEEDHAM. He added that in answer to your question.

By Mr. NEEDHAM:

Q. All I want to know is whether you treated that particular case as a departure from your usual practice, and therefore asked the authority of the business management in reference to it.—A. We felt we would like to know what other people thought of it.

Mr. NEEDHAM. That is all.



## Recross-examination by Mr. Wickwire:

Q. Your railroad company has been paying a substantial dividend for a good many years, has it not?

Mr. NEEDHAM. I do not know that that has anything to do with this case.

Mr. WICKWIRE. I simply want to show generally that it is one of the railroads which is in a strong financial position.

Mr. NEEDHAM. I will concede, on the record, if you want

Mr. WICKWIRE. That will answer.

Mr. NEEDHAM (continuing). That it is a strong company.

Mr. WICKWIRE. And has been for quite a good many years past.

Mr. NEEDHAM. Yes; there is no question about it. I will go further and concede that if the reasonableness of the rule can be determined by its use by a successful railroad for several years, then the rule is reasonable.

Mr. WICKWIRE. I am not going to make any concessions myself. That is all, Mr. Bailey.

Witness excused.

CHARLES A. LUTZ, a witness previously called and sworn in behalf of the respondents, was recalled and testified further, as follows:

Mr. NEEDHAM. If your honor please, at the conclusion of this witness's testimony yesterday I was under the impression myself that there was a misunderstanding between the witness and counsel with reference to a question which I asked the reporter to write up. It was done and that much of the record submitted to Mr. Lutz, who looked over it, and he desires to make a statement with reference to it.

The WITNESS. The counsel, as I read the question now, was asking me if a rule which permitted a charge to profit and loss for a track abandoned not in connection with any improvement, was a reasonable rule when compared with another rule; or in other words, if both rules were reasonable, the other rule being that if a track were abandoned directly in connection with an addition and betterment, it be charged to operating expenses. In some manner I did not understand just what the counsel was attempting to elicit, although it seems very plain on the record when I read it. I thought he was asking me about a rule which would permit a charge in advance of abandonment to operating expenses for property abandoned and not replaced, as well as a rule which would permit the same charge to profit and loss at the time of replacement in the event prior charges were not made for depreciation, and on that misunderstanding, I perhaps did not respond to his question. The answer that I would make to the question as I now understand it is that the rule is reasonable.

## Cross-examination (continued) by Mr. Wickwire:

Q. You stated yesterday that you understood the letters which counsel offered relative to the position of various railroad accountants and executives were all that were before the commission or its representatives at the time the subject of promulgating the classification of expenditures for additions and betterments was being considered.

Mr. DENISON. All those that took views in support or in opposition. There were some that took no position at all on that particular subject.

By Mr. WICKWIRE:

Q. You did not make this search yourself, did you?—A. No, sir.

Q. Are you at all sure that a complete and thorough search was made for that purpose?—A. Reasonably so. Our files, I think, are in reasonably good condition, and we have not had much difficulty in finding any letter to which we wished to refer.

Mr. WICKWIRE. I would like to request that counsel will have a more thorough search made upon that point, if he is willing to do so; and I wish specifically to call attention to particular letters, all, or nearly all, of which, according to my understanding, took the position opposite to the regulations of the commission: A letter from Mr. Ripley, the president of the Atchison, Topeka & Santa Fe Railway, dated May 24, 1909; a letter from Mr. S. B. Schuyler, the general auditor of the Missouri Pacific Railroad, dated September 12, 1907. I understand there are some other letters also from representatives of this company, of which I have not a specific memorandum. I understand there is also a letter from the president of the Delaware, Lackawanna & Western, and another letter from the general auditor of that company. Also a letter from Mr. J. S. Ford, auditor of the Chicago and Eastern Illinois, dated September 15, 1907, addressed to Mr. Adams. Also a letter from Mr. Kirkman, of the Chicago and North Western. Also a letter from Mr. Kochersperger, of the New York, New Haven and Hartford Railroad, dated September 13, 1907. Also a letter from Mr. R. A. White, the auditor of the New York Central and Hudson River Railroad Company. Also a letter from Mr. Delano, the president of the Wabash. I should have said the letter from Mr. White is dated April 15, 1909.

Also a letter from Mr. W. H. Williams, vice president of the Delaware and Hudson Company, dated September 28, 1908.

Mr. DENISON. Do you know to whom those were addressed?

Mr. WICKWIRE. A good many of them were addressed to Mr. Adams, as I understand, and probably a few addressed to Mr. Plant and transmitted by him to the commission.

Mr. DENISON. Will you have a further search made, especially for these letters?

The WITNESS. I will.

The COURT. The other letters were ruled out on your objection.

Mr. WICKWIRE. I am not offering these. I am simply suggesting to counsel that in making their offer and in having this witness testify those were all the papers there were taking a position opposing the regulations before the commission, that he was entirely in an erroneous position. I am not offering any papers at all, but I am suggesting to them for the purpose of—

The COURT (interposing). You want to protect the reputation of the witness. (Laughter.)

Mr. WICKWIRE. I think if this matter is to have any part at all in this record—

The COURT (interposing). I think we had better go on with this case.

By Mr. WICKWIRE:

Q. Referring to the hardships to which you stated yesterday some of the carriers might be subjected through compliance with these regulations, I will ask you whether or not those hardships would not be most likely to overtake the weaker roads of the country?—A. I am not certain just what reference I made to the hardships, but I should say that the weaker roads perhaps might have more cause to complain of the strict enforcement of the theory of the rule than would the stronger ones.

Q. Assuming that the cost of these grade reductions by means of relocation was \$600,000 and assuming that the railroad company in the first instance obtained \$600,000 from the proceeds of the bonds, which by the terms of the mortgage could be used only for improvements, and assuming further that in the first instance all of the money, \$600,000, was used to pay for the improvements, to pay for his work, then, as I understand it, it would become necessary, if the corporation complied with the requirements of the commission, to charge \$400,000 to operating expenses?—A. That is, assuming that the improvement is so made as to involve the abandonment of \$400,000 replacement cost?

Q. Yes; the so-called abandonment, the discontinuance of the use of that particular roadbed.—A. That is true.

Q. Then if it is charged to the operations, the operating expenses, is then paid in fact out of the operating revenue, it is not?—A. Yes.

Q. And there must be a readjustment of funds, so that when the adjustment has taken place the operating revenue will be reduced the amount of \$400,000?—A. It would be charged to operating expenses automatically.

Q. That would be the effect?—A. The net revenues obviously would be reduced \$400,000 from what they otherwise would have been.

Q. And that \$400,000 will then be restored to the bond account, will it not?—A. It will be in the cash box. I do not know that it will be possible to segregate as between current cash and capital cash. I do not think it is customary to do so in the cash box.

Q. But in effect, it will be restored into a property asset?—A. It will have the asset in the form of cash.

Q. So that you will then have an outstanding bonded indebtedness in respect of this matter of \$600,000, and you will have as assets representing it, an item of improvement of \$200,000 and cash \$400,000?—A. That is my understanding of it.

Q. Now, if the terms of the mortgage prohibit the use of that cash for anything except improvement the company will simply have to restore that \$400,000 pending further improvements, or will else have to restore it to the trustee of the bonds, to be used in the redemption of the bonds, will it not?

Mr. NEEDHAM. That is a conclusion with reference to the treatment of the bond. That is not involved here. This is a question of whether abandoned property should be charged. It seems to me hardly proper.

The Court. I think it is competent to inquire where this money should go to as bearing on the reasonableness of the rule.

Mr. NEEDHAM. This witness could hardly say where it would go to, because it is there as cash. It has been raised for a given purpose, and he is an accountant. He can tell what accounts it could appear in. I do not object to that.

The COURT. He can tell where it is to go to.

Mr. NEEDHAM. But for him to say where it would go under the mortgage involves a construction of the mortgage and is a question of finances.

Mr. DENISON. It is a question of law, too.

Mr. NEEDHAM. Yes; it is a question of law.

The COURT. Read the question.

The REPORTER (reading):

Now, if the terms of the mortgage prohibit the use of that cash for anything except improvement the company will simply have to hold that \$400,000 pending further improvements, or will else have to restore it to the trustee of the bonds, to be used in the redemption of the bonds, will it not?

The COURT. The objection is overruled.

A. I think that would depend upon the precise terms of the covenant in the mortgage.

By Mr. WICKWIRE:

Q. Yes; but at all events those moneys could not, if retained by the corporation or by the treasurer of the corporation, be used for any other purposes than simply denominated in the mortgage; they are charged, are they not, with the trust imposed by the mortgage?

A. I think that is a question of the construction of the mortgage and not of accounts.

Q. That would be your understanding, however, would it not, an accountant? A. I would have to read the mortgage.

Q. Assuming that the mortgage prohibited the use for any other purpose.—A. That would depend on the exact terms of the mortgage. If the mortgage prohibited their use for any other purpose than such a purpose as must be charged in its entirety, under the commission's rules, to additions and betterments and remain in the property account, the answer would be one thing. If the mortgage simply said second track, changes of line, and things of that kind, the answer might be another.

Q. Well, if the mortgage simply says— the question it seems to me is very simple— if the mortgage simply says it may be used for improvements it manifestly would not be used for any other purpose, would it?

Mr. DENISON. I object to that question. It is purely a question of law.

The COURT. I sustain the objection.

By Mr. WICKWIRE:

Q. Now, then, recurring for a moment in the course of this transaction to the period in which the corporation has paid the \$400,000 derived from the bonds in the making of this improvement, and before any adjustment has been made to conform to the regulations of the commission, then the corporation has no charge to its operating expenses in reference to this improvement?—A. Before it has made an adjustment in accordance with the rules of the commission.

Q. Yes.—A. Obviously not.

Q. If the corporation wished, following the practice that has been adopted in certain cases, for instance, one cited by Mr. Bailey, not to make any charge in respect of this improvement to operating expenses, it would be permissible for the corporation to let the matter stand right where it was, would it not?

Mr. NEEDHAM. That was not Mr. Bailey's statement. Mr. Bailey said expressly that it would be taken out of property account and charged to profit and loss.

Mr. WICKWIRE. If the question is objected to, I will withdraw it.

Mr. NEEDHAM. Yes; it is not his statement.

Mr. WICKWIRE. I will withdraw it.

By Mr. WICKWIRE:

Q. If the transaction stood in that situation that the financing of this improvement had first been done out of the proceeds of the bonds, and the corporation, through its board of directors, allowed the matter to stand there, then, obviously, there would be nothing taken out of the operating expenses and no charge made to it, would there? A. Do you mean that property has been abandoned just the same?

Q. Just the same. I am not speaking now of the regulations; I am saying irrespective of the regulations. A. Will you read the question?

The Reporter (reading):

If the transaction stood in that situation that the financing of this improvement had first been done out of the proceeds of the bonds, and the corporation, through its board of directors, allowed the matter to stand there, then, obviously, there would be nothing taken out of the operating expenses and no charge made to it, would there?

A. If the rules of the commission had not been complied with?

Q. If it had not yet been promulgated.—A. Yes.

Q. And under those circumstances an accountant could not make any charge to operating expenses, could he? A. I think that would depend entirely on his knowledge of the situation.

Q. But assuming that the board of directors had passed a resolution providing that the matter should stand just where it was, and that that expenditure for that improvement should be fully paid and should stand where it was by being financed out of the bond account? A. If the accountant was in the employ of the board of directors, he would probably do what the board of directors instructed him to do, if there were no law or rule superior to the board to the contrary.

Q. An accountant would have no right under those circumstances, would he, and no occasion to make any charge, as a matter of book-keeping, to operating expenses?—A. I do not think I would change my answer as just given to your previous question.

Q. Will you be kind enough to state it, so that I may understand it? A. I meant to say, and if I did not, I will now say, that if the accountant were employed by a corporation whose board of directors instructed him to treat entries in the manner you have indicated, he would probably do so so long as he wanted to stay in the employ of the company, assuming that there were no regulations of the commission or otherwise which would suggest a different course.

Q. In a situation like that, then, the determination of what funds shall finally pay the items involved in this transaction rests not with an accountant, but with the board of directors?—A. I should say so.

Q. And if the money in fact has not been taken, any of it, out of operating expenses, an account which is truthful and accurate can not show that anything has been deducted from operating expenses, can it?—A. I think that.

Q. Unless the transaction has taken place under a proper system of accounting, can any account be made which would state such a transaction?—A. The abandonment has taken place, and if the accountant were permitted to exercise his discretion, and I were the accountant, I should charge it to operating expenses.

Q. But assuming that it had been paid entirely out of the other account and that the board of directors determined it should be paid from that account, would you make the charge then to operating expenses, in addition to the other charges?—A. If I wanted to retain my position with the corporation, I would do what the board of directors instructed me to do.

Q. But would you, as a matter of sound accounting, state upon the accounts that this money had been taken out of the revenue, when, in fact, it had not been taken from that account, but had been taken from a bond account?—A. If the abandonments had been made in accordance with the idea embodied in the rule of the operating expense classification and the additions and betterments classification promulgated by the commission, and if I were the accountant for the corporation, permitted to exercise my discretion as the accountant for that corporation, I should certainly charge it to operating expenses.

Q. Suppose two railroad corporations were in operation and that neither one of them had any surplus—there was no charge or debt to the profit and loss account—and suppose, by virtue of their operations during that year, each accumulated a net income upon its operations, the balance of receipts over expenditures amounting to \$1,000,000; suppose that each one of those railroad companies had made grade reductions by means of relocations which required a total charge to operating expenses of \$1,000,000. Now, if one of those corporations should make the entries upon its books according to the regulations of the Inter-state Commerce Commission, the operating account for the year would show zero, would it not?—A. That is assuming that it exercised option No. 2, as indicated in my testimony of yesterday.

Q. Assuming that it exercised no option, but that it charged all of the cost of the so-called abandoned property to its operating revenue.—A. Directly to the operating expenses of the year?

Q. Yes.—A. Yes; that is true.

Q. So that the net revenue from operations would be exactly the same as the item, namely, \$1,000,000, which it had to charge by reason of this improvement.—A. That is to say, that after making the charge nothing would remain as net operating revenue?

Q. Yes.—A. That is correct.

Q. And in that case the corporation would be unable to pay any dividends?—A. It would be unable to declare any dividend from a statement of income for that year.

Q. For that year; that is what I mean.—A. Yes.

Q. And we have assumed that it started without any accumulated surplus, and it would therefore be unable to pay any dividend whatever in respect to its business for that year; is that true?—A. I think practically that would be true.

Q. You say practically that would be true. If there is anything about it that is not true I would like to know it.—A. Well, I do not know that I am familiar enough with the law respecting the declaration of dividends, and that is why I hesitate to answer.

Q. You understand that a corporation ordinarily, as a general proposition, can not pay a dividend unless it has earnings for that purpose, or surplus?—A. Would it not have a million dollars in its cash box?

Q. No; the money has been spent.

Mr. DENISON. I do not think Mr. Lutz heard you say "surplus." Did you hear him say neither earnings nor surplus?

The WITNESS. Well, neither earnings nor surplus; that is true.

By Mr. WICKWIRE:

Q. Assuming that the other corporation should apply to the Interstate Commerce Commission for relief from the strict operation of the regulation as to abandoned property, and should obtain the permission of the commission to spread its charge of \$1,000,000 over a term of ten years, \$100,000 in each year, then the amount which would be charged to operating expenses would be \$100,000?—A. For 1 year.

Q. For that year; yes. And the net operating revenue of the corporation for that year would then be how much?—A. \$900,000.

Q. And that would be applicable to the payment of the dividend?—A. I should say so.

Q. So that the question of whether these two corporations can pay or can not pay a dividend is dependent upon whether the commission acts favorably or unfavorably upon their applications for relief in case they make it?—A. Possibly so.

Q. So that the determination, then, of whether the corporation can pay a dividend is not regulated by the law of the State in which the corporation is created solely, but is respected and affected by the regulations of the commission.—A. Well, I should say there were other things which affect the ability to pay dividends than merely the law of the State or the regulations of the commission. The regulation of the commission, if that is what counsel is referring to particularly, would admit of a showing of \$900,000 in that year if the application of the carrier was granted, as against nothing with respect to the other corporation if it elected to charge directly to operating expenses the entire amount of the abandonment.

Q. And, to a considerable degree, therefore, the question of whether dividends may or may not be paid is dependent, first, upon the election or nonelection of the corporation to apply to the commission for relief, and, second, upon whether the commission will grant the relief or not?—A. I think that is a fair assumption.

Q. You made some statements yesterday, as I understood you, to the effect that the ideal system of bookkeeping required that abandonments of the character involved in this case should be anticipated by provisions made in advance during prior years, so that when the time arrived that the improvement was made, the funds would

be applicable with which to make that improvement. Did I correctly understand you?—A. I think so.

Q. And these regulations, as I understand it, are framed in conformity with this theory of an ideal system of accounts.—A. Not wholly.

Q. In respect to this particular matter under consideration?—A. Not wholly.

Q. In what respect is it out of harmony with the ideal system?—A. In permitting the options which I have indicated of spreading those charges over the future.

Q. You regard it, then, from an operating standpoint, as not entirely sound in all of its provisions?—A. Not in harmony with ideal accounting thought, as I understand it.

Q. As a matter of fact, do you think that in the practical running of the accounts of railroad corporations it is feasible to anticipate these improvements that may be made from time to time, and to prepare for them?—A. Not always.

Q. The theory presupposes, does it not, something that is, to a large degree, impossible?—A. I would not say to what degree it is impossible. Take a carrier which has committed itself, for instance, to a thoroughgoing grade revision, as I understand the Kansas City Southern has; certainly that company, when it has committed itself to that sort of a plan, anticipates the abandonments which will be made as a result of that plan, and to the extent that it had determined to proceed with these improvements, it would then have such knowledge as would enable it to anticipate at least some of the charges for abandonment.

Q. Then, if I understand it correctly, the ideal system would have required that the Kansas City Southern, at the time it commenced operations years ago should have anticipated that the day would arrive when it was necessary to lower its grades, and that it should have commenced at the beginning of its life to set up a reserve and to set aside a certain amount of money every year, so that, in ten or fifteen or twenty years, whenever the period might arrive when the grade reductions were requisite, it would then have the fund on hand with which to meet that expenditure?—A. That would be a very conservative policy.

Q. That would be conforming to this ideal system of accounting to which you have referred?—A. I think it would, if there had been any means by which any adequate rate might have been determined.

Q. Do I understand that a system of setting up reserves of this kind has been in general vogue among the railroads of this country?—A. I do not understand that it is.

Q. In fact, if such things have been done, they are very rare and exceptional, are they not?—A. This situation has been met at least measurably in another way by a great many carriers—

Q. Yes; but I am speaking now of this way.—A. This particular way?

Q. Yes. Has it been in general practice in the history of railroading in this country?—A. No; I do not believe it can be said to have been a general practice.

Q. In fact, it has been an exceedingly rare practice, has it not?—A. To do it in that particular way?



Q. Yes. — A. Yes.

Q. By setting up a reserve in anticipation? — A. Yes; to do it in that particular way, but if I may explain—

Q. Let me follow out my line of thought. Let me ask you, is that an ideal system of bookkeeping or accounting, if you please, or is it an ideal system of railroading? — A. Well, I think it is both. I think the railroad is subject to the same general conditions that a manufacturing plant is subject to.

Q. Yes. — A. And that is to take care of its depreciations during the life of the property which is being used up.

Q. Now, the ideal system of accounting can not in any way be applied to it, can it, unless the railroad has adopted the ideal system of railroading? — A. Unless it is known and anticipated that abandonments are going to be made, it is impracticable to set up a reserve to take care of them.

Q. Now, if we should have an ideal demonstration —

MR. NEEDHAM. Your honor, I want to object to further examination along the line of an ideal system, that has not been put in force, and which is not in controversy in this case.

THE COURT. I sustain the objection.

MR. WICKWIRE. If your honor please, it seems to me that this is pertinent to determine the soundness of this witness' conclusions, as an accountant, to ask him upon what theories and upon what principles his conclusions are based that these regulations are fair and proper. If his conclusions are based upon an erroneous foundation, his conclusions that these are correct regulations, based upon what might be termed principles of accounting, which can be shown not to be sound, it seems to me that that directly affects the testimony of the witness and the weight of his testimony as an expert. I am making these inquiries for that purpose.

THE COURT. Well, the business of a corporation may be conducted in a certain way, and it may be different from the way in which the commission requires accounts to be kept; so I do not see just how the way that a corporation conducts its business is relevant to the question of the reasonableness of this rule.

MR. WICKWIRE. The point which I have in mind, if your honor please, with respect to that, is that a system of accounting is a record of the company's transactions, and if the transactions of the corporation are one thing, and the accountant stands there ready to record them, his work is another thing, and what he writes down in his record does not affect what is actually done by the board of directors and operating officials in regard to the physical work of the enterprise and in regard to the transaction of its business. The auditor simply stands there to record what is done; and if a corporation, in fact, has not set up a reserve and made no determination that it will do it, that it will use one penny for the purpose of building up a reserve, how can an accountant go to work and set up a reserve on his own hook? It seems to me, therefore, that I am entitled to show that his system of bookkeeping or accounting—the so-called ideal system—is in reality not a system of bookkeeping, but is a system of railroading.

THE COURT. I think you have developed that subject far enough.

MR. WICKWIRE. That is all.

Redirect examination by Mr. DEXTER.

Q. Mr. Lutz, in the theoretical system of bookkeeping, would there be any alternative methods of describing the same transaction?—A. I think not.

Q. Why were these alternatives provided in this case?—A. I think as a concession to the practical situation involved.

Q. And what was that practical situation?—A. That great objections were urged by a number of carriers to the establishment of depreciation charges with respect to way and structures and also equipment. The representatives of the commission thought that they had sufficiently well analyzed this matter to justify them in recommending depreciation charges with respect to equipment. It was not felt that the matter had been sufficiently analyzed to require depreciation charges with respect to way and structures, in the face of the decided objections of so many of the carriers.

Q. Were there also objections to the alternative by which the whole thing could be charged out through profit and loss?—A. I do not recall.

Q. When you were asked about the effect of preventing dividends, the alleged effect of preventing dividends, did you mean to state or assume that any definition which the commission prescribed in the matter of accounts would have any legally binding effect, or would be considered by the commission to have any legally binding effect on the question of the issuing or paying of dividends?—A. I think I specifically disclaimed any knowledge of the legal questions involved.

Q. What provision is there for subsidiary accounts to permit a carrier to explain fully the fact that the operating expenses had been extraordinarily increased through abandonments?—A. All of the classifications prescribed by the commission admit of the setting up by the carrier of subaccounts under any of the primary accounts prescribed for any purpose for which the carrier desires to use them, simply being required that a list of those accounts be filed with the commission, subject to its disapproval.

Q. As a matter of practical accounting, even in the reports of the commission, the swelling of the operating expense account occasioned by the charging to that account of abandoned property, can be plainly explained?—A. It can.

Q. Is there any objection on the part of the commission or anything, so far as you know, in its rules, to prevent a complete explanation to the stockholders of that same fact?—A. None whatever.

Q. Or to prevent the rendering of reports to the stockholders in any form that the company choose to make?—A. I think there is nothing in the commission's regulations which will prevent that.

Q. In fact, has not this petitioner made its reports to its stockholders in connection with its old methods, notwithstanding the change of the accounting system required for the purposes of the commission?—A. I have not seen a report to the stockholders recently so that I can not say.

Q. What was the practice of the Louisville & Nashville Railroad Company—that is the one you were connected with, is it not?—A. Yes.

Q. (Continuing.) Prior to the promulgation of the rules in respect to the accounts for additions and betterments?—A. The accounts for additions and betterments were, in the main, determined in connection

go with the rule which charged to operating expenses the cost of replacing in kind the property abandoned. I say "in the main," because I do not think that large abandonments, such as that involved in this case, were specifically charged out of property accounts. It was, however, the custom of that company to charge directly to its operating expenses, in addition to the renewal charges for bridges and buildings, and things of that kind replaced, large sums for improvements and betterments along its line. Take, for instance, the matter of equipment. The plan was to charge to the regular renewals accounts in operating expenses the cost of replacing equipment when it was retired. In some instances it even went so far as to put in a new car for an old one, even though the new car might be of an improved and more expensive type than the one which was retired, and, in addition to that, large sums were charged to an account in operating expenses known as "improvements to equipment" for new and additional cars not taking the place of any previously existing. That plan was followed in the charging directly to an operating expense account, which it called "improvements to way and structures" of the addition and betterment features, a considerable number of improvements.

Q. What would have been done with any \$300,000 item similar to the one involved in this case, that is, the cost of the improvements in building the new line, the new locations?

Mr. Wickwire. It seems to me that this is not material. I do not wish to be unduly technical, but to go into the specific facts of one railroad company.

Q. Correct. It has been testified to here as to the practice of certain railroad corporations as to how they treated these matters, and this is not that same line. You may answer the question.

A. I think probably an item of the nature referred to would have been handled by charging the entire amount to the property account, especially if the money had been raised from a bond issue; but during the same year in which this charge was made to the property account, the company would have pursued, and did pursue, its policy of charging directly to operating expenses these large sums of which I have spoken for other additions and betterments.

Mr. Wickwire. That is all.

Mr. Wickwire. May it be made a part of the record that the Louisville & Nashville Railroad Company is a road of very strong financial position?

Mr. Wickwire. Yes.

Mr. Wickwire. And has been, for many years?

Recess examination by Mr. Wickwire.

Q. There was no uniform practice in effect on the Louisville & Nashville Railroad in respect of these matters, was there? A. Not with respect to the large matters; no. There was a uniform practice in determining the amount chargeable to improvements and betterments, whether apportioned to expenses or put into the property account, with respect to bridges, buildings, and sidetracks, and things of that kind, constructed, replacing old. They substantially set the rules now prescribed by the commission in determining the amount charged to additions and betterments and then apportioned

part of the sum assignable to additions and betterments to operating expenses, in addition to the renewal charge, at times.

Q. But there was no uniform regulation or rule prescribed during the course of the time when you were connected with that company's business for treating upon a uniform basis these various items as to whether — A. No; I think that the road handled it very much as great many others did in accordance with its desires.

Q. And treated the matter as one largely within its own discretion and business judgment, did it not? — A. I think it did.

MR. WICKWIRE. That is all.

By MR. NEEDHAM:

Q. Mr. Lutz, you have stated that you were with the commission and active officer in charge of the bureau of accounting at the time these rules were adopted. State whether or not, so far as you had to do with the matter and in so far as you know, regarding any action of any other officer, these rules were adopted in any sense with reference to the strength or weakness of any carriers. — A. They were not.

Q. The adoption of the rule had for its purpose, as you have stated, so far as the property account is concerned, a system that would show, at any given time by its balance, the actual cost of the existing property —

MR. WICKWIRE. One moment. Has not that matter been all gone over?

MR. NEEDHAM. I have not gotten through with the question yet.

By MR. NEEDHAM:

Q. (Continuing.) Was there any other purpose in the mind of yourself or any others in so framing the regulations but to accomplish that result? — A. I think the commission, in its reports to Congress, indicated that should the question of valuation ever be taken up the appraisers would find the classification of accounts prescribed by the commission in harmony with the rule which would reflect the property accounts only such property as the appraiser would find.

Q. In determining the rule with reference to the property account and the charge as to the operating expenses there was no purpose in your minds to make it hard for the poor roads and easy for the rich roads? — A. None whatever.

MR. WICKWIRE. There is no suggestion or contention that there was any desire to favor any particular class. The only suggestion on our part has been that the operation of these regulations be heavily upon the weaker roads.

MR. NEEDHAM. That is all, Mr. Lutz. Your honor, do you wish to go on now with the last witness on our side?

THE COURT. You can not possibly finish to-night.

MR. NEEDHAM. No, sir.

THE COURT. Then we will stop here and adjourn until to-morrow morning at 10 o'clock.

Whereupon, at 4:20 o'clock p. m., the hearing was adjourned until to-morrow, Saturday, December 14, 1912, at 10 o'clock a. m.

WASHINGTON, D. C.,

*Saturday, December 14, 1912.—10.00 o'clock a. m.*

Present: Mr. Justice Carland.

Appearances: Mr. Arthur M. Wickwire, for the petitioner; Mr. Winfred T. Denison, Assistant Attorney General, and Mr. Thurlow M. Gordon, special assistant to the Attorney General, for the United States of America, respondent; Mr. Charles W. Needham, for the Interstate Commerce Commission, intervening respondent.

## PROCEEDINGS.

Mr. NEEDHAM. Mr. Adams will be sworn.

HENRY C. ADAMS was called as a witness on behalf of the respondents, and, being first duly sworn, testified as follows:

Direct examination by Mr. NEEDHAM:

Q. State your full name and occupation. —A. Henry C. Adams. I hold the professorship of political economy and finance of the University of Michigan.

Q. How long have you occupied that position? —A. As full professor since 1887. I lectured there, and also at Cornell and Johns Hopkins University for six years before that.

Q. Upon what subject? —A. Upon political economy and public finance.

Q. What experience have you had in connection with railroad economics? —A. I have been in charge of the statistical division of the Interstate Commerce Commission since the fall of 1888.

Q. Up to what time? —A. Up to a year ago last June.

Q. What other experience have you had in this line? —A. I had the special experience that came from the task of developing for and recommending to the Interstate Commerce Commission a uniform system of accounts which it undertook after the passage of the Hepburn Act. I had leave of absence from the university for two years and had the control of the development of that work for four years, until I left the commission.

Q. What time did your leave of absence of two years cover? —A. I think it was the years 1907 and 1908, but I still controlled the work after that.

Q. It was entirely in your charge as head of the department of economics and accounting? —A. In charge of what afterwards was organized as the bureau of statistics and accounts, with the two divisions, of accounts on the one hand, and statistics on the other.

Q. Have you had any connection as advisor or otherwise with State commissions or the work of State commissions or railroad organizations? —A. Yes, sir. At the outset of the work undertaken by the commission along the statistical line, there was organized an association of State railway commissioners, and at the beginning there was established in that association a standing committee on railway statistics. I have always been a member of that standing committee, with the exception of one year; the other members being representatives of State railway commissions.

Q. That organization or association was composed of officials of States? —A. Yes, sir.

Q. As railway commissioners? —A. Yes, sir.

Q. Are you a member of the association of railway accountants that has been referred to here?—A. I am an honorary member of that association, not a voting member.

Q. How long have you been an honorary member of it?—A. I do not know. It was when Mr. Waterman was president, and that would identify it if it is necessary. It is a long time ago.

Q. Can you approximate it?—A. 1892.

Q. Will you give the precise date when you were called to the work in the Interstate Commerce Commission?—A. 1888. I was called in the fall when the first annual reports to the Interstate Commerce Commission were just coming in. Those forms had been issued and the carriers had made their first report, and I was asked to come in first to suggest a method of compilation, and that resulted in my staying longer than I anticipated at that time.

Q. When did you become permanently connected with the commission in the position which you have defined?—A. As statistician to the commission?

Q. Yes.—A. I was not aware that you would care to know these matters in detail, but I think it was in the early part of the calendar year of 1889.

Q. And at that time, as I understand, you began the formulation and development of a system of uniform accounts and reports?—A. Yes.

Q. From railroads, as required by the Interstate Commerce Commission?—A. Yes, sir; with the emphasis at that time on the reports, and the influence upon the accounts was only such influence as could be exerted through the requiring of reports and the revision of reports. The specific development of a system of accounting did not arise until 1906, I think.

Q. Under what specific authority of Congress was that work begun and carried on?—A. Primarily under the 20th section of the act, though there are other sections that refer to the result of this work.

MR. NEEDHAM. Of course, your honor, it is not necessary for me to read this statute; it is familiar to the court.

THE COURT. Oh, yes.

By MR. NEEDHAM:

Q. I ask you now whether or not in the report to Congress by the Interstate Commerce Commission in the year 1908 this matter and the outline of the work needed was stated?—A. In a general way; yes, sir.

MR. WICKWIRE. Is that 1898?

MR. NEEDHAM. 1908.

THE WITNESS. May I ask to have the question read?

The question was read by the reporter.

THE WITNESS. Do you mean in the report of the commission to Congress?

MR. NEEDHAM. Yes, sir.

A. In this report, as in all reports, there are included the work of the statistical division and recommendations. This report that you show me is a general statement as to the peculiar needs of the commission respecting a satisfactory balance-sheet statement, which is one part of the system of accounts.

By Mr. NEEDHAM:

Q. That part of the work, the balance sheet, was undertaken when?—A. That was the next to the last classification which was undertaken in the development of the general system. I believe the income account was undertaken after that.

Q. And when was that work as a whole completed in the first instance; that is, the first issue?—A. Do you mean of the balance sheet or of the classification?

Q. Of all the work.—A. The first classification that was issued was the classification of operating expenses, and that became effective in 1907. There followed outside operations and construction accounts and this additions and betterments classification, and then there was taken up this subject of the balance sheet.

Q. And when was that completed?—A. That was in 1910. The date of its issue was 1910.

Q. And the date of its issue is shown by the published issues which are attached to the answer in this case?—A. Yes, sir; but the discussion upon this subject was fully three years before that.

Mr. NEEDHAM. Yes. If your honor please, I should like to have it understood with counsel, if possible, that these reports of the commission to Congress which are published in this form can be used, or such parts of them can be used as desired on either side, without formally introducing them into the record. If that is not understood, then I will have this part of this report, which is on page 85 of the report of 1908, read into the record. This is the report to Congress.

Mr. WICKWIRE. These are public records, which may be properly cited in the briefs or otherwise. Will not that answer your purpose?

Mr. NEEDHAM. Well, there has been some question raised in one case where even the order of the commission, which is published, was relied upon as a part of the evidence, and it was stated that it must be introduced, or otherwise, by some formal agreement, that it can be referred to in argument, but this states the positions of the needs of the Interstate Commerce Commission. Therefore I should like to use it as evidence and have it understood that it may be used.

Mr. WICKWIRE. With respect to the orders to which you refer we already have a stipulation that the orders and classifications, copies of which are annexed to your answer, may be regarded as having been received in evidence.

Mr. NEEDHAM. Yes.

Mr. WICKWIRE. With the right of either party to use in the record any portions thereof desired.

Mr. NEEDHAM. I want now the same understanding with reference to these reports or the statistical reports, if there is anything in the statistical reports that you desire to use.

Mr. WICKWIRE. It does not seem that it is necessary to make this a matter of evidence in the case, but that, as a matter of current history, they may properly be referred to in our briefs and on the argument.

Mr. NEEDHAM. Then I shall have to have this copied in, because I want to use this. I want this understood to be as a statement by the commission at that time of their position and wishes in regard to these matters. I thought if we could use this it would save copying it.

Mr. WICKWIRE. If that will not answer your purpose, then I am willing to make the stipulation you desire. I understand it refers to all classes of public documents.

Mr. NEEDHAM. Simply the reports to Congress and the statistical report, if you desire to use the statistical report; that is, the one you have in your hand.

Mr. WICKWIRE. Yes. The stipulation should also apply to the publications known as Statistics of Railways in the United States.

Mr. NEEDHAM. Yes.

Mr. WICKWIRE. Issued under authority of and by the Interstate Commerce Commission.

Mr. NEEDHAM. It seems unnecessary to print these in the record as long as they are printed.

Mr. WICKWIRE. Yes.

By Mr. NEEDHAM:

Q. Now, Mr. Adams, will you state in your own way the considerations which, at the outset of this development of this system of accounts, were constantly before yourself and your department and the commission?—A. Do you wish me to develop that question in my own way?

Q. Yes; just state it so the court will understand it.

Mr. WICKWIRE. Would it not be possible to have this done in the usual manner, by question and answer, and then if there is anything—

The COURT. Yes; that is the better way.

Mr. WICKWIRE. I shall object to—

The COURT. You can keep closer to the question in that way.

By Mr. NEEDHAM:

Q. Will you, then, take up, first, the annual and monthly reports of the carriers? What were the particular purposes in view of the formulation of the annual reports and the monthly reports of carriers to the commission?

Mr. WICKWIRE. I object to that as immaterial.

The WITNESS. I can answer that first question, I think, very concisely.

Mr. WICKWIRE. Well, I will withdraw the objection.

The WITNESS. I think I can do that very concisely and perhaps save time. The considerations which influenced me personally, as in charge of this work, were three or four, leading and controlling in character. First among these, I should say, was the desire to recommend to the commission, for promulgation under its order, a system of accounts that represented the best American practice. I think that in this regard—indeed, I know—that the commission agreed with that point of view, and it was because it was desired that this system should represent the best American practice that the commission approved my suggestion that we cooperate with the representative of the railways in this matter. There was nothing new in this view in 1906, because I think there was confidence on both sides and a very hearty cooperation between the statistical division and the accounting representatives of the railroads since 1888. This was a conscious consideration to me, because I had studied the accounting methods in some particulars followed in England and on the Continent and had been familiar with the development of the American accounting



method for so many years, and I was convinced that, in general, the practice on American railways was the best practice in the world. Now, the second consideration, however, arose out of the fact that in my service with the commission I was obliged to regard these matters from a public point of view, and I think I may say that in every case where my recommendation to the commission differed in any way from the recommendations of the accounting officers it was traceable to this difference.

Q. The accounting officers of the railways? A. It was traceable to this difference in the point of view.

Mr. WICKWIRE. It seems to me that is immaterial—a general statement of what considerations actuated him with regard to various matters which are not involved here.

Mr. NEEDHAM. It seems to me very material to show the purposes of this classification which is attacked as unreasonable. We have to take the point of view of the people who made it.

The COURT. Yes. The whole object of these reports is for the purpose of obtaining the bases for the commission to act, who do represent the public.

The WITNESS. There were, as I remember, only three cases where there was a marked difference of opinion between myself and the representatives of the carriers, and the point involved in this case is one of those three. Another consideration that controlled me consciously in my recommendations to the commission was the language of the interstate-commerce act and the decisions of the courts in dealing with the cases involving railway questions. I studied those opinions as well as I was able and endeavored to construe, for the purpose of deciding upon accounting questions, the language of the interstate-commerce act in the light of current decisions. I thought it was proper to recommend to the commission such classifications of accounts and such definitions as would secure the information in such shape that it would be of use to the Federal commission, to the State commissions, and to the courts in dealing with this class of questions. Finally—there is only one point further—I held constantly in mind the statistical needs of uniform accounting instructions, in order that the compilations published by the commission and the items that are selected by the newspapers for publication and that whatever use that may be made of the statistical conclusions might represent as near as possible the facts; and from my experience I was conscious that a final conclusion could have no greater confidence than the confidence that could be placed in the original field note, but, more than that, that lack of uniformity in definitions by various carriers might lead—although from the point of view of each carrier the report itself is correct and trustworthy—might lead to untrustworthy conclusions when these various reports of carriers are put together in compilations to be reported to the commission. Very briefly stated, I think those are the considerations under which I tried to develop this system of accounts.

By Mr. NEEDHAM:

Q. The value of the reports for use by Congress, and by the commission, and by courts, and by statisticians for comparison as to the progress of a single carrier or for comparison between one carrier and another, depended largely, did it not, upon a uniform definition of

different items entering into the reports, and uniform classification of those items?—A. That is absolutely necessary.

Q. Will you now come to the item of the classification of additions and betterments in this general system of accounts, and state its construction—I mean how it was constructed—and its purpose?—A. You mean the place that this classification of additions and betterments occupies in the scheme of accounts?

Q. Precisely.—A. The classification of additions and betterments is, in fact, a classification that pertains to construction, and is to be regarded as one of the two classifications issued by the commission that are designed to secure a proper record of railway construction. It differs only from the original construction in that it is construction subsequent to the time that the property is taken over for operation. It, of course, has relation to other classifications through the balance that is determined from these construction records. Thus, it has reference to operating classifications, and, in a broad way, it represents a number of entries and items, and also refers to the third general heading of accounts, namely, financial accounts, covered by what is known as the income statement and the balance sheet statement.

Q. Coming now to the treatment of abandoned property, will you state the reasons and how this was constructed, and the purposes in view?—A. Do you mean the rule for crediting to the property account property abandoned as a part of the classification of additions and betterments?

Q. Yes; I am speaking now entirely of the classification of additions and betterments.—A. In order to understand this rule and the reasons for its promulgation, it would seem to me necessary to recognize it in connection with the commission's rule in operating expenses, namely, that additions and betterments should be excluded from operating expenses.

Q. In that connection, Mr. Adams, you may, if you choose, refer to the conditions existing at that time in railway accounts.—A. Prior to 1906 it was the general practice, or at least a very common practice, of railroads in this country, to improve their property out of revenues, which is doubtless a conservative policy; but improving their property out of revenues, they did that by charging additions and betterments directly to operating expenses, and when the classification of operating expenses was under consideration, it was recognized that this practice led to certain unfortunate results, and, on that account, the commission in its classification of operating expenses adopted the rule that hereafter additions and betterments should be charged to property and not to operating expenses. That was in recognition of certain evils that flowed from the common practice.

Q. Now, taking out of the operating expense account these betterments which were added to the property proper, as permanent improvements, what was done with abandoned property, with reference to the property account, I mean?—A. It was thought necessary in order to obviate overstatement of the property account, and the continuous cumulative overstatement of the property account by the rule, all additions and betterments, regardless of the source from which the money is obtained, should be charged to the property account. I should say it was regarded as necessary to require that all abandonments of property should be credited to the property account.

Q. Why?—A. In order that the property account at all times would represent as near as possible the property actually used at that time in the service of transportation, and also because, I think—I am speaking now from what I know to be the attitude of the commission in this matter—because the commission feared that the exclusion of additions and betterments from operating expenses and their inclusion in property, would lead to an overcapitalization of the road and what is commonly known as the result of British railway accounting, and it was recognized that the evils which everyone concedes with regard to the English situation at present are due not to the exclusion of additions and betterments from operating expenses and the inclusion of all additions and betterments in property, but to the failure to eliminate property abandoned when property, in the course of developing the system, is thrown away.

Q. In that respect, did you have distinctly in view the provision in section 20 of the act which requires the annual reports and accounts to state "the cost and value of the carrier's property," and the rulings of the courts in cases involving a claim of confiscation, that the carrier had the right to earn a return upon the value of the property that is put to the public use?—A. Yes; that was what I had in mind as one of the ruling considerations in the development of this system.

Q. If additions and betterments had continued to be placed in the operating expenses, the property account would not then have shown the cost of the entire property put to the public use by the carrier, would it?—A. No, sir; that would result in the carriers having more property appropriated to the service than it recognized on its ledger. It would be in the nature of what accountants call a secret reserve.

Q. Then, the object of taking the additions and betterments out of the operating expenses and requiring them to be placed in property account was to make that account state accurately the property which had been placed by the carrier to the use of the public?—A. Yes, sir; and which was at that time used.

Q. Yes; and the purpose of requiring all abandonments to be taken out of that account was to make it at all times a correct balance of the property at that time in use?—A. That is true.

Q. You have referred to what is known as the British method. With reference to the property account as distinguished from what you call the best American method, will you just state that in a word?—A. My understanding of the so-called British method is that all improvements—I am speaking generally now, you understand—all improvements, additions, betterments, and new construction are provided for out of the sale of securities and charged to the property account, and that no credit is made for the property abandoned in connection with an improvement scheme; that is, it is dictated entirely by the wishes of the stockholders.

Q. The fundamental difference, then, between what you call the British method and the best American method as to this account is that the American method requires property abandoned to be taken out of that account?—A. Yes.

Q. Either at its value or its reproduction value?—A. Yes, sir. May I say, so as not to be misunderstood, that I would hardly know what it is meant by the British scheme of accounts? When I used that phrase I meant what I understand to be the general practice, and also the practice approved by the British courts.

Mr. WICKWIRE, May I ask a question?

Mr. NEEDHAM, Yes.

By Mr. WICKWIRE:

Q. Am I to understand, Mr. Adams, that you refer now to the system of railroading in England or to the system of accounting in England?—A. No, sir. I want to guard myself, if I may be explicit, from being compelled to give an opinion upon that recent report to Parliament controlling railway accounting. What I have reference to is that general system of accounting approved in England as applied to British railways; that is responsible for their \$250,000 capitalization a mile.

Q. What I wish to find out is whether the trouble, if there is trouble, in England is due to the defect in their system of accounting or whether it is due to an error in the policy on the part of the stockholders in England as to how the corporation's business should be done. As I understand it, the accountant simply reflects what the corporation has done, and therefore I would like to have you explain whether the trouble in England is really not in their system of railroading rather than in their system of accounting.—A. No; I think not.

Mr. NEEDHAM, Your honor, I did not ask him about the accounting system in England. I asked him about what has been referred to by others as the British method. Whether it is in accounting and not railroading, it makes no particular difference. There is a distinct difference in the treatment of property account in the two countries. Whether that is material or not, I do not know, but it has been referred to by the witnesses, and our own system has been spoken of as the best American system. I simply wanted to show where the difference was. That was all.

The COURT, You may cross-examine later in regard to that.

By Mr. NEEDHAM:

Q. Up to the present time, Mr. Adams, and at the time you were formulating these accounts, there had been no provision made by Congress for the valuation of railroads?—A. No, sir.

Q. For the purpose, then, of rate making, and for the purpose of determining questions in litigated cases, where confiscation was claimed, if it was improved, you may state the improvement, of having an account kept with the commission that should correctly state the cost of the property actually in use at a given time, when questions either of making a rate or determination of a claim of confiscation are to be decided.—A. My understanding of that situation, at least the understanding that dictated this system of accounting, is that a rate at issue would be confiscatory or nonconfiscatory according as it produced a sufficient revenue to pay operating expenses, taxes, and a proper return upon the investment; the investment being measured by the value of the property actually in use, and that it was therefore necessary to the accounts of the commission to secure the cost of the property as the first step in enabling the courts to arrive at the value, which could be used in any specific case.

Q. And, as a working element in fixing rates, that the commission might have the information as to the balance of the cost of the property then in use for any purpose they might need?—A. That is the purpose of the accounting system, and it works that way, for all

additions and betterments or construction since 1907. Of course, we could not go back of that date.

Q. I call your attention now directly to the charge of abandoned property, such as the item in controversy in this suit, to operating expenses. Will you now develop the purpose of that rule, especially with reference to property abandoned and replaced in kind?—A. The reason for including in operating expenses a charge designed to write out of the accounts, the property abandoned having been credited to the property account, is that operating expenses may take care of the entire maintenance of the property, and this is regarded as the recognition of a form of depreciation.

Q. Did you describe that as depreciation caused by inadequacy or obsolescence, where the depreciation is caused by improvement of roadbed and equipment, to use a general phrase?—A. My statement in answer to your question was general. Of course, depreciation itself is capable of analysis, an analysis in harmony with the conditions under which and causes which occasioned the depreciation, and it was in part because of this fact that the alternative rules or options that have been referred to were worked out. That is, depreciation is either the recognition of depreciation to take place in the future, the recognition of present depreciation, instantaneous, or the recognition of depreciation that has taken place in the past. Now, it was recognized that the accounting character of this depreciation is somewhat different, but they were all depreciation and ought to go into maintenance charges.

Q. Does it include —A. I beg your pardon. May I correct that?

Q. Yes.—A. Into the maintenance charge or into profit and loss. There are certain conditions under which it will go into profit and loss.

Q. Does that item include the depreciation caused by what has been denominated here inadequacy or obsolescence? I use the phrase that has been used by the witnesses, and you have heard the witnesses testify.—A. I think it does.

Q. Prior to the adoption of these rules, I understand you to state that all improvements had been written into the operating expense account by the railroads, or at least that was a common practice?—A. Not all; no, sir; but it was quite a common practice. Of course, improvements could be paid for out of the proceeds of bonds, or, after the operating expenses have been closed, they could have been made by appropriations and resolutions of the board, making that an income charge.

Q. Yes; but it was a common practice, as I understand you, to charge into operating expense all improvements and betterments.—A. It was a common practice; yes, sir.

Q. That being the case, the operating expense would take, as part of those improvements, or retain, the cost of abandoned property—it would be in that account?—A. May I restate that in my own way?

Q. Certainly, certainly.—A. As a result of that there would be no necessity for a rule crediting or reducing the property account by the abandoned property, in case the amount that was added to that property was, in fact, a charge to operating expenses, and so not recorded on the ledger, and exceeded the abandoned property.

Q. Yes. Under the rules as formulated requiring all betterments to be carried into the property account and all abandoned property

to be credited out and charged to operating expenses, state whether or not this method forms a complete history of all investments made by the company in the railroad property.—A. I so understand it. From additions and betterments charged and from abandonments credited, and the ledger records, it would give a complete history of the property.

Q. Prior to that time, there would be no history of abandoned property in the accounts, generally speaking?—A. The engineer maintained, of course, a record of all improvements, and at least there was a record in that way, but not in such a manner as to affect the balance sheet statement or the reports to commissions.

Q. The result of this system of accounting, then, is that in each current year these accounts state accurately the amount of investments in railroad property and the extent, if any, of abandonments during that year?—A. Yes, sir; I so understand it. They require that every transaction be brought into the accounts, which are summarized in reports to stockholders and to commissions.

Q. And to the public?—A. Yes, sir; and to the public.

Q. Will you now state the reasons, in your opinion, and the reasons that prompted you in formulating these accounts, why these charges to operating expenses for abandoned property should not be charged to profit and loss?—A. May I answer that question by concisely stating what I recognize as an accounting principle?

Q. Certainly.—A. I think that a study of the accumulated surplus, the way it comes into existence and the uses made of it, shows that there are but two classes of charges that can properly be made to the profit and loss, that is to the accumulated surplus—and by “charges” I mean not an analysis, so that the effect of the charge is on one side of the balance sheet and a charge that really reduces the surplus—and these are, first, a charge which is in the nature of the distribution of that surplus—

Q. What do you mean by “distribution”—distribution to stockholders?—A. To the stockholders, that is to the persons—

Q. Or under their direction?—A. (Continuing.) To the persons, whoever they be, representing a proprietary interest, as the accountant calls the common stockholder; but, of course, there are other ways of recognizing that besides the declaration of a dividend.

Q. Yes.—A. The second class of charges besides those that represent an equity of that kind in the accumulated surplus are charges in the nature of corrections of previous accounting errors, or of adjustments to bring the present statement into correct shape, because something that transpired in the past is not recognized until the present time.

Q. Will you illustrate that now?—A. Well, in the case of a railroad a transportation service might have been rendered and the revenue from that service accrued and entered into the gross revenue of the company, and it might be found afterwards that a portion of it might be freight to be collected, and the road could not collect it. The writing off of a bad debt would be a profit and loss charge.

Q. What would be the disposition of an item of depreciation like this: Assuming that, at a given time, the company owned one thousand freight cars and one hundred of those cars were destroyed or wrecked, and for that reason went out of use; that no record of it is

made in the accounts until a year or two afterwards, when the matter comes up for distribution. Where would that depreciation, when so presented, be charged and why?—A. You will permit me to try to keep these terms straight as I understand them.

Q. Yes.—A. I should hardly call the dissipation of assets due to the wreckage "depreciation," that is incidental to operation of the property, but is an expense but—

Q. Very well; call it an expense.—A. (Continuing.) To answer your question, if you can conceive of a case where one thousand cars had disappeared—

Q. I said a hundred.—A. Well, a hundred is just as good.

Q. Yes.—A. And no account had been made until it was found out and discovered by the delinquent operating officer two years afterwards, I should think that probably that would come under the correction charge. It would be a profit and loss charge.

Q. If it had been reported at the time it occurred, in the year it occurred, it would to that extent have reduced profit and loss?—A. Yes.

Q. Therefore profit and loss is swollen by the fact that that was omitted?—A. Yes, sir. I think this should be said, however, so as to make that matter more clear, that as I understand it an accounting officer would first ask himself the question whether this was a common occurrence or in the nature of a lap over from one year to another year, and if it were, although technically it did not belong to the year in question, it would be charged to the operating expense of the year in question; but if it were so very unusual as to exclude it reasonably from that year it would be a profit and loss charge.

Q. Where a carrier finds that it is developing a new traffic over its line which it desires to encourage and carry in the future, and that traffic requires special equipment or facilities, and, looking to the future development of that business, it seeks to make provision for it by additions and betterments, and as the work of providing for it progresses abandonments take place; that the company desires to anticipate such abandonments in the future as incidental to such a progressive programme, what distribution would be made under this system of such, of the cost or reproduction value of such abandonments, less salvage of course?—A. They would be reported as an operating expense charge.

Q. State now how those could be provided for under the rules, by looking to the future and assuming them to arise in the future.

A. You mean in the case of the first recognition of future depreciation?

Q. Yes.—A. Which warrants the present investment?

Q. Yes.—A. In that case—

Q. I will assume that sufficient facts have been laid before the business management to warrant them in adopting that business policy.

A. Yes.

Q. As a good business policy. Now, how could they, under the rules, anticipate and provide for the depreciation which would be incidental to such a programme of improvements?—A. The abandoned property could be carried on the balance sheet as a deferred asset and written out of the accounts by subsequent charges to operating expenses.



Q. Could the company anticipate these abandonments by creating a sufficient reserve to meet them from year to year as they occur?—A. Yes, sir. In that case there would be no necessity of carrying the abandoned property for any time on the balance sheet as a deferred asset, because at the time of abandonment it could be charged against the reserve.

Q. If, however, the company in such a case should determine it to be a better policy to do the work at once and get the benefit of the improvement in developing its business, it could scatter the payment of it over future years?—A. Yes, sir.

Q. I mean, with the consent of the commission?—A. Yes, sir; upon the assumption that, under those conditions, and the future development of the business being one of the purposes of the investment, that there would be an increment due to the investment equal to take care of those charges in the future.

Q. The result, then, stated in a single question, is that the company, desiring to carry forward a program of improvements, and anticipating that ten years from now there would be charges for abandoned property incident to making the improvement at that time, it can anticipate it by putting up a reserve during the ten years?—A. Yes.

Q. So, if the improvement is to cost a million dollars, they could put up a hundred thousand dollars a year out of their operating expenses to meet that?—A. Yes, sir.

Q. And the company could make its improvements now and spend its million dollars and spread the payments over ten years, one hundred thousand dollars a year, which would be precisely the same result, so far as the operating expense account is concerned?—A. So far as the amount of the operating expenses is concerned; yes, sir. So far as the amount charged to operating expense is concerned.

Q. From year to year?—A. During the period considered; yes, sir.

Q. Would be the same?—A. Yes, sir.

Q. In one case there would be an accumulating reserve to meet it at the end of ten years, and in the other case the expense would be carried in a reserve account chargeable to operating expense during the period of ten years to come?—A. Yes, sir.

Q. You understand, Mr. Adams, we are in all of these questions referring to the cost or reproduction cost of abandoned property. I am not speaking of the entire improvement, of course.—A. Yes, sir; I so understand you.

Q. The sound business policy which would lead to the adoption of the last option and making the improvement at once would be induced by desire on the part of the company to have the benefit of the use of the improved conditions for existing traffic and also to stimulate in a more rapid way the development of new traffic, would it not?—A. That is a proper consideration leading to such a conclusion on the part of the management.

Q. You heard Mr. Lutz's statement with reference to the historical development of this matter and the negotiations which were carried on with the Association of American Railway Accounting Officers?—A. Yes, sir.

Q. And you have referred to it yourself. Have you anything to add to that statement?—A. I think not.

Q. It has been practically stated as it occurred?—A. Yes.



Q. I ask you, then, whether in the development of this system of accounts you also conferred and cooperated with the State railroad commissions to any degree?—A. Yes, sir. The practice was to take this matter up with the American Railway Accounting Officers' Association and to discuss it at the same time with the representatives of the State railroad commissions. The committee that I discussed these things with was the so-called committee on statistics.

Q. Of State railway associations?—A. Of State railway commissioners.

Q. That association you have already referred to as made up?—A. Yes, sir.

Q. They have a general committee on accounts?—A. No, sir; on statistics.

Q. Excuse me.—A. On statistics. But the recommendations to the Interstate Commerce Commission of these accounts for promulgation under order were not made until, through this statistical committee, they had been referred to the State railroad commissioners in their annual convention. Whether that was true with regard to each and every one of them I do not know, but that was the general practice.

Q. The purpose of these conferences with the railroad accountants was to bring to the surface and attention of the commission the practice of the railroads and the views of their accountants with reference to a proper accounting system?—A. Yes, sir.

Q. What was the purpose of the conference with the State railroad commissioners?—A. The purpose of that was to continue a policy very early inaugurated by the Interstate Commerce Commission of securing cooperation between the Federal commission and State commissions. The first constructive work that I undertook back in 1899 was to eliminate the multiplicity of annual reports required from carriers, and the States were very ready to cooperate in that matter. For several years the most active committee in the association of State railway commissioners was the committee on statistics that had in view the unification and the reducing to uniformity of the annual reports, and to-day the reports to the Interstate Commerce Commission and to the States are practically uniform.

Q. The purpose of these conferences, then, was to secure uniformity, as far as possible, in so far as the subjects were alike, between State commissions and the Interstate Commerce Commission?—A. Yes, sir; and I may say that the States very willingly followed us through the development of this system of accounts.

Q. With reference to the matter in controversy in this case, the treatment of the property account, and the operating expenses, and especially with reference to abandoned property, what is the practice in the States as compared with the practice of the Interstate Commerce Commission?—A. I can not answer that with absolute definiteness, but —

Q. So far as you know.—A. But, so far as I know, the States have adopted, and are enforcing, the rules promulgated by the commission. Of course, there are some of the States that have powers exceeding the power of the commission, and they go further in some respects than the Federal commission has gone.

Q. With reference to the treatment of abandoned property, so far as you know?—A. So far as I know, that is the case.

Mr. WICKWIRE. One moment. I think that is going a little too far, to have the witness state what the regulations of the various States are.

Mr. NEEDHAM. Well, I am through with him.

Mr. WICKWIRE. Without producing some competent evidence with regard to this matter.

The COURT. Well, counsel says he is through.

Mr. NEEDHAM. One more question, Mr. Adams.

By Mr. NEEDHAM:

Q. It has been stated here that in this particular case the result of the charging of the reproduction value of these items of roads that have been abandoned to the operating expense account would, or might, prevent the Kansas City Southern Railway Company from paying a dividend upon preferred stock, and that the accounting system is responsible for that. What can you say upon that subject?—A. In my judgment, that is not true, especially in view of the testimony which has been submitted and in view of my reading of the Burt report. This investment was undertaken because it was believed that there would be a decrease in expenses and an increase in revenue over the amount necessary to pay a 5 per cent dividend on the investment; that is, it was supposed that there was a surplus—

Q. No; right there, Mr. Adams. I got Mr. Burt's report somewhat mixed yesterday, I believe, in my questioning. I wish you would now read into the record the part of Mr. Burt's report to which you now refer.—A. I think, sir, that is already in the record, because I saw the stenographer copying it.

Q. Well, just to be sure, I want to see that the record is right.—

A. Yes. In what I have said, my judgment is based upon other things than this report, than what is here. What you refer to is on page 17 of the report.

Q. This report is in evidence?—A. Yes.

Mr. NEEDHAM. I would like to have it identified, and you can use it as much as you like.

The WITNESS. It is already copied.

Mr. NEEDHAM. Let the stenographer copy all of that part in.

The portion of the Burt report referred to is as follows:

First. The revision of grades and alignment of the Kansas City Southern Railway on the line of "preferred revision" is fully justified, as follows:

*Total estimated cost of grade revision and establishment of main line via Ft. Smith (exclusive of change of terminals as shown in note to Table 4 above.)*

Revisions and changes of operated road	\$6,444,677
Establishment of main line via Ft. Smith	2,030,193
Total	8,474,870

Interest on above cost at 5 per cent per annum	423,743
Estimated gross saving per annum from operation on reduced grade with existing density of traffic	577,763
Estimated net saving per annum from operation on reduced grade	154,020

By Mr. NEEDHAM:

Q. Mr. Adams, you may proceed and state—A. What is the question?

Q. What have you to say as to the claim that the accounting system was responsible for the failure of the Kansas City Southern to pay its interest on its preferred stock, or that such a result would follow the charging of this abandoned property to the account?

Mr. WICKWIRE. Now, I must object to that question as immaterial, because it seems to me that that is purely a question of law and a conclusion.

The COURT. I sustain the objection.

Mr. NEEDHAM. I think that is all.

By Mr. DENISON:

Q. I would like to have you explain, Mr. Adams, the principle that lies beneath the distinction which was made between an improvement on an old right of way, not involving an abandonment, and an improvement on an adjoining right of way, which involves the abandonment of the old right.—A. In the first case all the money that has been expended in the work done in the original construction has been charged to the property, and the improvement being on that line is in the nature of additional work and calls for additional charges.

Q. The piece of property remains the same, but it has been made to cost more?—A. It has been improved without doing it in such a way that it in any way deteriorates for the use for which it was designed. Its use is improved. In the second case the property which you have used is represented by the cost of the improvement, and only by the cost of the improvement. The previous cost is, for the purpose of operation, useless and, under the definition that I have given of property, is no longer in the service of transportation. It is simply a difference of fact.

Mr. DENISON. That is all.

The COURT. I would like to ask one question.

By the COURT:

Q. One of the objections urged against this rule which requires abandoned property to be put into the expense account is that it compels the road to make an entry that is not true. Now, why was it necessary, in order to accomplish the object that the commission had in view, to wit, that the property account should show correctly just the property that the railroad company had in use, to have that abandoned property and its cost put into the operating expense account? If—taking this present case—the cost of this new improvement was \$600,000 and the reproduction cost of the abandoned right of way of the property was \$400,000 would not the property account have been made to state its true position, conceding that the abandoned property must be entered in some account, by charging the property account with this \$600,000 and crediting it with the reproduction cost of the abandoned property? Would not that accomplish the purpose that the commission had in view? What I do not understand here is why it was necessary to put it into the operating expense account.—A. It is necessary, in some way, your honor, as I understand it, to write that property out of the property account.

Q. Yes.—A. It stands, in the case of property, as the first item on the asset side of the balance sheet.

Q. This \$600,000?—A. Yes; as original construction.

Mr. DENISON. No; you mean the \$400,000.

The WITNESS. The amount, whatever it was, of the original construction.

Mr. DENISON. Of the property abandoned.

The WITNESS. Now, that property is taken out, in fact, and to make the ledger correctly reflect the property that is used, it must be taken out of that property account. Now, that is reflected in the profit and loss or accumulated surplus on the balance sheet, and, in some way, the fact that the property has been reduced in fact must be reflected in the accounts.

By the COURT:

Q. If the reproduction cost of the abandoned property is credited in the property account, would not that accomplish the same result?

Mr. DENISON. That is, the \$400,000.

A. Yes, sir; that is the rule. It is to be credited in the property account; but if you credit property account, than that must necessarily affect the profit and loss on the other side, which is the equivalent to a charge to profit and loss —

By the COURT:

Q. Now, why do you put it in the operating expense account?—A. We put it into the operating expense account because it would be a wrong charge to profit and loss and because it is a maintenance charge. That is necessary. The controversy on that point is as to whether this charge, the purpose of which is to write out of the account the property abandoned, is a maintenance charge or a profit-and-loss charge. The commission recognize it as a maintenance charge and not a profit-and-loss charge.

By Mr. DENISON:

Q. Why do you recognize it as a maintenance charge that should go against future operating expenses?—A. Because the occasion of that abandonment is depreciation, and depreciation must be met in order to maintain the property and keep property back of the securities that were there in the first place.

Q. Then, also, is it not the fact that if it were written out through profit-and-loss account, there would not be a basis in the capital account for a maintenance of the existing state of rates?—A. That is true. The amount that is written out—may I state that in another way?

Q. Yes.—A. If that were dissipated, say, in dividends to the stock holders, that would be equivalent to the paying of dividends out of capital and not out of earnings.

Q. Further, is it not a fact that writing it out through operating expenses has the effect of conceding to the company a financial position which would have an effect during the pendency of the payments through operating expenses of tending to justify higher rates than otherwise would be justified?—A. I should say yes to that question. It is a recognition that operating expenses cover enough to permit the corporation to fill up in its real assets the hole that was created by the abandonment, so that the securities have got back of them the full amount that they had when the operations began.

Mr. DENISON. That is all.

Cross-examination by Mr. Wickwire:

Q. You stated that the first classification of operating expenses was promulgated in 1907. You mean the first one under the Hepburn Act adopted in 1906, do you not?—A. The first one issued under order of the commission; yes, sir.

Q. Prior to that time there had been a classification of operating expenses which was in use by the carriers in making their returns to the commission, was there not?—A. Yes, sir; there had been one printed.

Q. What was the year in which that was issued?—A. The history of that is given in the letter preceding the present classification, if I can get that. [A paper was handed to the witness.] I never remember these things. No, it is in the first one.

Q. All I want, Mr. Adams, is the approximate date of the issue of the first classification.—A. I think it was about 1893 or 1894. But prior to that there was what is known as the Saratoga classification which was in existence and used by State commissions before the Interstate Commerce Commission was created.

Q. There was then, as early as 1895 a classification promulgated under which the carriers of the country made their reports to the Interstate Commerce Commission?—A. Yes, sir.

Q. Covering operating expenses?—A. That is true, as a part of the instructions for the annual report. That was not under order of the commission.

Q. There was also a first revised issue of the classification issued in July, 1894, was there not?—A. That is the date, yes, sir. That the first revised issue.

Q. Will you kindly refer to the introductory letter contained in the classification of 1907 which gives some historical data, and state whether 1894 was the date of the first revised issue?—A. Yes, sir; that evidently is true.

Q. When was the second revised issue promulgated?—A. I would rather get somebody else on the stand for those things; I have forgotten them. [A paper was handed to the witness.] The second revised issue became effective July 1, 1901, according to this statement which I signed, and is correct.

Q. Did these earlier classifications beginning some time, according to your testimony, prior to 1894, contain any requirements that abandoned property should be charged to operating expenses?—A. No, sir; no such provision would be included in the classification of operating expenses.

Q. If they were in fact operating expenses, why would it be improper to have a classification dealing with the subject of operating expenses state that they should be so treated and charged?—A. I thought to so state it, to tell the truth, but we had not got that far.

Q. You had not got that far?—A. No, sir.

Q. The first time when the regulations, prepared under your direction, required that abandoned property should be charged to operating expenses, was the time of the promulgation of the classification of additions and betterments in 1909; is that true?—A. Yes, sir.

Q. So that for a period upward of 18 years prior to that time, the regulations prepared under your direction made no such require-

ment?—A. There were no regulations prepared under my direction, issued under order of the commission. The regulations were in the nature of instructions—prior to that time they were in the nature of instructions—for the making out of reports to the commission. What you say is true. Before the thing was done it was not done.

Q. If charges for abandoned property are properly chargeable to operating expenses, will you please state why in the preparation of these earlier classifications and regulations you did not include charges for abandoned property therein?—A. Because of the hopelessness of enforcing such an order until after the Hepburn Act.

Q. Did you consider it was hopeless in 1907 to promulgate such a regulation?—A. No, sir.

Q. So that the failure to do so in 1907 was not due to the hopelessness of enforcing the regulations?—A. No, sir; not subsequent to the Hepburn Act. I understood you to ask with regard to the previous classification.

Q. I was inquiring with regard to all of them.—A. I do not know as you care to know, but the delay was simply due to the fact that the problem was a mighty big one, and we did not wish to take any undue advantage of the carriers, but to get their position, to go deliberately, so that when we reached the end we had something which would stand.

Q. Have you had any experience as a practical railroad man?—A. In the employ of the railroads?

Q. No; I mean in regard to the operation of railroads, and the conduct of railroad business.—A. Nothing except consultation practice.

Q. But I mean as an executive or director of a railroad company?—A. No, sir; I never was a director or an operating official.

Q. Had any provisions been contained in these earlier issues of the classification of operating expenses prior to 1907 making any requirement that depreciation charges should be made to operating expenses?—A. You mean formal depreciation charges recognized in the accounts as such?

Q. I want to know if there were any regulations requiring depreciation to be charged in those earlier classifications?—A. No, sir. The depreciation all through that time, so far as it was recognized, was recognized as simply having reference to repairs. The title of the account was "Repairs and renewals," if I remember rightly. The new classification, the one now in use, analyzes that account under three heads—repairs, renewals, and depreciation.

Q. You recognize, do you not, Mr. Adams, that there is such a thing as the cost of progress in the building up of a railroad property?—A. The cost of progress?

Q. Yes.—A. I recognize certainly that there always are expenses in connection with progress, and that the throwing away of what has cost you something, before it is really worn out, is an expense. If that is what you mean by the cost of progress, I recognize there is a cost of progress.

Q. Could not an item denominated cost of progress be included as a subdivision of the so-called property account, and could it not as matter of bookkeeping, be treated as covering the items which might justly be denominated cost of progress?—A. Do you mean in operating expenses or the balance sheet?

Q. I mean in the balance sheet.

Mr. NEEDHAM. You mean as defined by the witness? I do not know what you include in your term, "Cost of progress." I should like to know what we are talking about. If you adopt his definition, then we will know what you mean.

By Mr. WICKWIRE:

Q. If it were required to retain in the property account certain items denominated "Cost of progress," which could be kept there as a subdivision of the primary account.—A. I will answer your question, assuming that the cost of progress means abandoned property, if that is right.

Q. I do not assume at the moment that it means that, but anything that is a fair expenditure in the improvement and development of the property.—A. Oh, then, I think I understand you. This same item which has already been charged to property, if it is a fair expenditure in bringing the property to what it is, then it must have been charged to property. Answering your question, you can do anything with your accounts. I had supposed that the accounting rules of the commission had provided so that from the records of the company you could read that cost of progress and accumulate it at any time you wished to do so. The way the commission does that, according to its rules, is that this which I now understand to be cost of progress, meaning an expense which had already been charged to property, no longer exists because of the progress; that it for the time being will be carried as a deferred asset on the balance sheet and then charged out by charges to operating expenses, so that the public bears the expense of the cost of progress. I do not mean, sir, to evade your question. I only mean that I can not think of any particular thing under that head, "Cost of progress," to be treated in the accounts, unless it is a cost that first is entered into the property statement.

Q. The regulations of the commission now in effect provide that under certain circumstances there may be carried in this property account, do they not, a charge denominated "Abandoned property chargeable to operating expenses"?—A. No, sir.

Q. Is not such a charge necessarily made in the balance sheet?—A. I understood you to say the property account.

Mr. NEEDHAM. You said the property account.

The WITNESS. If you mean the balance sheet, yes, sir.

By Mr. WICKWIRE:

Q. In the balance sheet?—A. In the balance sheet, yes.

Q. It is the asset side of the balance sheet?—A. No, sir; it is the liability side of the balance sheet where that account appears. It is in the nature of a reserve set up from the revenues. It is a part, in fact, of your accumulated surplus, but it is not the surplus that is available for further determination by the board. It is set aside as having been accumulated in a distinctive way; that is all. I was wrong in saying it was not subject to the determination of the board. It is not a reserve in that sense, but it is an analysis showing the manner in which that portion of the accumulated surplus has been accumulated.

Mr. NEEDHAM. You are speaking at present of an accumulated surplus to mean abandoned property, if I understood the question.



The WITNESS, I do not understand that is the question.

Mr. WICKWIRE, I think the witness misunderstood my question.

Mr. NEEDHAM, I think so.

By Mr. WICKWIRE:

Q. Where the commission permits a charge of this character to be spread over a term of years. A. Of charges to operating expenses.

Q. Yes.—A. Yes, sir.

Q. Then, as I understand it, there is carried in the assets account an item denominated "Abandoned property chargeable to operating expenses?"—A. Yes, sir.

Mr. NEEDHAM, That is not a surplus; that is, it is not an accumulative fund; it is a charge for abandoned property.

Mr. WICKWIRE, Yes.

By Mr. WICKWIRE:

Q. What I want to ask you is whether an item of that character being permissible in the asset side of the balance sheet, a subdivision known as "Cost of progress" might similarly be used in that side of the balance sheet?—A. Which would result, do I understand, in the nature of a charge to property so as to increase the assets?

Q. Not to increase them, but perhaps to represent them.—A. I cannot see how it could come into the account.

Q. Might it not be used as a substitute for this other account?—A. Oh, it might; but it would not be true.

Q. The question is not whether it would be true or not; the question is whether it might not be carried there as a subdivision—if it was understood what its definition was—as a sub-division of the property account.—A. If it is a real, true analysis of this charge that you are talking about, it certainly could be entered into the account. Anything that is a true analysis can be entered in the accounts.

Q. If property is abandoned for any reason during the period of construction, to what account is that charged?—A. I could not answer that until I knew the reason why. If it comes under that head of experiments, of what the engineer calls his ten per cent contingency, it would be charged to the property, but I should think if it went beyond that usual limit, it would be somebody's loss somewhere.

Mr. NEEDHAM, Do you mean limit as to the ten per cent, or limit as to the definition?

The WITNESS, I meant the money limit at that time. What I mean to say is this, that every railroad in making a contract with a construction company will allow over and above the strict cost of the things that are going in, and the labor, a certain margin for contingencies, and up to where the margin for contingencies is reasonable, it is a part of the original cost.

By Mr. WICKWIRE:

Q. Suppose there was an abandoned embankment during the course of construction, and another embankment was constructed and used, and the first one abandoned and not used, would the cost of the first embankment be charged to property account and carried in the property account?—A. If it were reasonable in view of the facts of each case.

Q. If it were not reasonable, to what would it be charged?—A. It would be charged either to the loss of the contractor or to the loss of the stockholders of the railroad company having such a contract.



Q. I am not speaking of any contract. I assume the railroad is building it and is using its own money. —A. Then it would be a profit-and-loss charge.

Q. Then it goes into the property account, does it not, all of it? —A. No, sir. I am speaking now of what would be regarded as an unreasonable loss, which could only be explained by the fact of some error or mistake. Now, errors and mistakes must be considered as a loss and not as a property charge.

Q. So that the corporation, if it had a charge to profit and loss, could begin its operations with a deficit? —A. Yes, of course, if it keeps that in its account, it must.

Q. Did you ever know of any railroad corporation which began its operations with a deficit upon its accounts? —A. No; I never did. You asked me, however, as to the character of that charge, and where, in view of its character and the conditions that arose, it should be charged. It is a loss and would be reflected in the accounts if entered at all as a loss.

Q. In case these additional sections involved in this case were improved, as set forth in the petition, and in case the original portions of the line were also retained for a time in use, and were not abandoned, then there would be no charge in respect of the old portions of the line, either to operating expenses or to profit and loss, would there? —A. No, sir.

Q. Suppose now, after a few years, the directors should determine to abandon one portion of the line, the old portion of the line, then the charge would be made to what account? —A. You mean after a sufficient time so that this property which was dis-used at the time of the improvement has been assigned to another service? This was used as a sidetrack?

Q. We will say as a passing track. —A. Yes, as a passing track, and as such has really identified itself as a passing track?

Q. Yes. —A. With the new operation?

Q. That is assumed. —A. Now, owing to a change of the dispatcher's methods, with local trains, or something, it is no longer used, and also it is not replaced anywhere else—is that right?

Q. Yes. —A. It would be charged to profit and loss.

Q. It is not replaced anywhere else except it is no longer used, because these other portions of the track have been constructed which are used. —A. I inserted that phrase "no longer used anywhere else," because, as I understand it, it is very common in changing the length of operating divisions to take up a siding at one place and put down siding at another. Of course, in accounting it is perfectly proper to put those two one against the other, so that there would be no abandonment at all.

Q. One would be a mere substitution of the other? —A. One would be a mere substitution for the other; yes. If you eliminate all that, then there must have been some radical change in the operating conditions which changed the situation, and the time has been so long that it is impossible to identify that abandonment with the original improvement; then I think it would be a profit-and-loss charge.

Q. You would not make it, then, to operations at all? —A. In that case, through that cycle of changed conditions, it would not be an operating expense charge, as it would have been had it been abandoned immediately.

Q. On the theory that you suggested before that these matters, if anticipated, are provided for by setting up a reserve, your idea would be that this abandonment was of such a character that reserves should have been set up for it to take care of it when it came, and inasmuch as that has not been done the operating expenses should not be charged with it.—A. No, sir.

Q. How do you differentiate?—A. Is this the other question in another way? I merely ask, to understand.

Q. As I understood you, your point was in regard to this abandonment; if it were an incident to the improvement, then it was proper to charge it to operating expenses. But if it happened to come two or three years later and was an independent fact, then it was not chargeable to operating expenses.—A. That is true.

Q. Now in either case, is not that one of those things which, according to your theory, should have been provided for by a depreciation reserve and therefore treated in exactly the same manner in either case?—A. I think it is wise financial policy and good accounting so to do where the conditions are such that it can be done with reasonable accuracy; but those are matters of judgment, and conditions change.

Q. And whether that shall be done or not in your opinion is a matter that is properly within the discretion of the board of directors as a matter of policy.—A. With this reservation, that in all of these cases, as I understand it, in two ways the law gives the commission a right to at least express its opinions for itself upon whether that discretion has been exercised in a reasonable manner. One is that this discretion is reflected in the annual and monthly reports to the commission, and those reports are made the subject of a more or less extensive correspondence, after careful examination. The other is that Congress has provided for a board of examiners, with authority to examine the accounts, call for papers, and thus investigate. Therefore, if the examination discloses any departure from a sound interpretation of the situation, so that a public interest was in any way involved, I understand that that would be within the province of the Federal Government through the commission to do something with.

The Court. I think we will have to suspend here. What time do you want to take this up on Monday? At the same hour?

Mr. Wickwire. We will be ready to go on, if your honor please, on Monday, whenever the court wishes.

The Court. Very well. We will adjourn until 10:30 o'clock Monday morning.

Thereupon, at 12 o'clock noon, an adjournment was taken until Monday, December 16th, 1912, at 10:30 o'clock a. m.

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WASHINGTON, D. C.,

*Monday, December 16, 1912—10:30 o'clock a. m.*

Present: Mr. Justice Carland.

Appearances: Mr. Arthur M. Wickwire, for the petitioner; Mr. Winfred T. Denison, Assistant Attorney General, and Mr. Thurlow M. Gordon, special assistant to the Attorney General, for the United

States of America, respondent: Mr. Charles W. Needham, for the Interstate Commerce Commission, intervening respondent.

## PROCEEDINGS.

The COURT. Will you finish to-day, Mr. Needham?

Mr. NEEDHAM. We are through, your honor, but, of course, we do not know what there will be in rebuttal.

The COURT. Will you finish to-day, Mr. Wickwire?

Mr. WICKWIRE. I hope to, your honor. We have some little evidence in rebuttal, but that will not be very extensive, and I hope to finish to-day.

H. C. ADAMS, the witness on the stand at the taking of adjournment, resumed the stand and testified further, as follows:

Cross-examination by Mr. WICKWIRE:

Q. In order that the record may be completed with respect to the date of the issue of the first classification of operating expenses, will you be kind enough, if you do not have it in mind, to ascertain what the date was, in order that it may go into the record?—A. I will. Do you mean the first classification of the operating expenses?

Q. Yes.—A. Because the one that is now issued is called the third revised issue.

Q. The one that is issued under the authority of the act of 1907 so-called, as I understand it, the third revised issue.—A. Yes.

Q. Of that classification?—A. Yes.

Q. The record already shows the date of the first revised issue and of the second revised issue, and I desire now to have the date of the first issue.—A. I will give you a complete history of that.

Q. Yes. As I understand you, those classifications issued earlier than the year 1907 were not promulgated by an order of the commission making it obligatory upon the carriers to conform to that classification in keeping their accounts, but that the commission issued these in connection with their instructions to the carriers as to the form of their reports to the commission. Is that correct?

Mr. NEEDHAM. If your honor please, I desire to object to this line of examination, upon two grounds: First, that the classifications made prior to 1909 are not in controversy in this suit and were not classifications made for the same purpose or to attain the same ends as with the same consideration that was given the classification of 1909 and subsequent issues, which are involved in this suit; and, secondly, that it is not cross-examination.

Mr. WICKWIRE. If your honor please, the situation, briefly, is this, I understand it, that these classifications were prepared by the witness, and according to the principles of accounting should, I take it, have contained everything that properly belonged in operating expenses, if they were drafted upon correct and complete principles of accounting; and I think it is competent, in order in the cross-examination of this witness to show that he did not recognize any such principle as is now contended for at the time he prepared and at the time these earlier classifications were issued.

Mr. NEEDHAM. I did not object to the question to the witness as to whether or not in former classifications we had omitted to require

this charge to operating expenses. That has been testified to by the witness, and I do not object to that question being asked the witness as an expert. That has been admitted. Now, to go into those classifications, to introduce them and discuss them, it seems to me to be entirely unnecessary. He has stated that they were not in those classifications.

Mr. Wickwire. I think counsel has misapprehended the purpose of my question. I am not endeavoring to go into those classifications at all. I was simply endeavoring to show how they were used by the commission and what their purpose was. If the question may be read, I think that will be clear.

The COURT. I overrule the objection.

Mr. Wickwire. Read the question.

The REPORTER (reading):

As I understand you, those classifications issued earlier than the year 1888 were not promulgated by an order of the commission making it obligatory upon the carriers to conform to that classification in keeping their accounts, but the commission issued these in connection with their instructions to the carriers as to the form of their reports to the commission. Is that correct?

The WITNESS. That is true.

By Mr. WICKWIRE:

Q. And all of these earlier classifications were prepared by you or under your direction—the first classification, the first revised issue and the second revised issue?—A. The second revised; yes. My memory does not carry me back to the first. I am not sure, but my impression is that we call the Saratoga classification, which is the classification which was made by certain State railroad commissioners, of which Charles Francis Adams was a member when it was, I think, a member of the Railroad Commission of the State of Massachusetts, was made by them; and when the form of annual report was adopted, at the time of the beginning of the Interstate Commerce Commission, that classification was accepted. That antedates my connection with the commission. My impression is that that is what we call the first classification, the first issue. Then, after I became statistician of the commission, there was a revision of this in connection with the accounting officers' association.

Q. Yes; but you became connected with the commission in 1888?—A. 1888.

Q. Now, do you understand that the first issue was promulgated prior to that date?—A. I would have to look that up.

Q. Yes.—A. But my memory is, in calling this the third, we call that Saratoga classification the first, in order to designate it.

Q. At all events, all of those which were promulgated and used after—A. I may be entirely wrong in this. I have not thought of it for years.

Q. (Continuing.) After you were connected with the commission had your sanction and approval?—A. Yes; it had my sanction; in fact, all of the issues that were made of the classification.

Q. I have just been handed a copy of what purports to be a copy of the original classification. I hand it to you and ask you if you are now able to give the date.—A. This is doubtless what was regarded as the first issue, and it is dated July 31, 1888, and the letter is signed

for the commission by Mr. C. C. McCain, auditor. That was before I came to the commission.

Mr. WICKWARE. I will now offer in evidence, first, the classification of operating expense, which appears to bear date July 31, 1888; also the revised issue of this classification, which bears date June 15, 1902; and also a later revised issue, which states that it took effect July 1, 1904. I suggest, for the purpose of abbreviating the record, that the other side may have included in the record or may cite any portions of this that they may desire, without.

Mr. NEEDHAM. Under the objection, which I desire to present, that can be understood. I object to these as immaterial and irrelevant to the issues in this case.

The COURT. Why do you offer these?

Mr. WICKWARE. I am not certain that it is at all necessary, as the witness has stated that these did not include abandonments of the character involved in this case.

The COURT. You do not maintain that the commission, having issued a classification one year, can never change it?

Mr. WICKWARE. No, indeed; but I am cross-examining the witness and he promulgated these later classifications, and I have offered to show that at that time he did not include items of this character in that classification.

The COURT. I think I will sustain the objection. I do not know how it is material, the mere fact that they did not include this classification. It is hoped that in such matters there is progression, from information and knowledge gained.

Mr. WICKWARE. May I have an exception, your honor?

By Mr. WICKWARE:

Q. I call your attention to the Statistics of Railways in the United States for the year 1907, and I will ask you to state whether this was prepared under your direction?

A. Yes, sir; it was.

Q. Will you be good enough to read into the record the portion which is indicated, beginning on page 20?

Mr. NEEDHAM. Just let me look at that.

Mr. WICKWARE. Certainly.

Mr. NEEDHAM. How much of this do you want him to read?

Mr. WICKWARE. Just this portion [indicating].

Mr. NEEDHAM. Why read it into the record? We have agreed that these documents can be used by either side, and I omitted to read into the record some parts of the report of 1908 that I wanted in order to not incumber this record. These are all printed and are issued. These are public documents.

Mr. WICKWARE. This will form the basis of some questions which I desire to ask the witness, and I believe it will make his examination more intelligible if that is now put in the record.

Mr. NEEDHAM. It is all right to call his attention to it, if you want to make it the basis of the examination, but I do not see the necessity of reading into the record a whole page of printed matter.

The COURT. These are documents of which the court will take judicial notice. You can call them to his attention.

Mr. WICKWARE. Well, I will withdraw the offer.

By Mr. Wickwire:

Q. Calling your attention to the statements appearing in this book at pages 20 and 21, and referring to the question of how abandoned property should be treated, it is set forth that this is the most serious of the technical questions, yet raised in the development of a uniform system of accounts, and a point upon which the public as well as the carriers have a vital interest. I call your attention to the following statement, namely:

On the part of the public the argument is strong in support of the proposition that the balance sheet statement "Cost of property" should cover only that property actually used in rendering the service of transportation, and that abandoned property should therefore be taken out of the account; but the argument of the stockholders also has merit, which is that inasmuch as the property abandoned was abandoned to make way for providing the public with better facilities (for it must be held in mind that the question at issue arises in connection with additions and betterments) and further, inasmuch as the first investment was necessary in order that the second investment might be made, it is scarcely just to require the stockholder to sustain the entire loss.

Will you state whether or not that was the view which you then entertained?—A. It was.

Q. Is that the view which you now entertain?—A. It is.

Q. You regard it, then, as obvious that the stockholder should not be compelled to sustain the loss occasioned by abandonment of property?—A. I think so. I never quite appreciated the way the Massachusetts law treats that matter, namely, to make the stockholders bear that whole burden, and not call to their assistance the public, as users of the property. It seems to me that it is a matter of public improvement and progress, and that it is impossible from the point of view in which the courts treat the problem of confiscations, to keep that property in the property account, and that the public ought to help bear that burden. Indeed, in the commission's system of accounting, I think it bears the whole of it.

Q. I was not asking for your opinion as to whether the public bore all the burden, but the point was that you are satisfied that it is not fair that the stockholders should bear it.—A. Yes; I am satisfied that the stockholders' interest ought to be regarded in all these matters.

Q. Will you allow me to ask you whether this is not an important consideration in that particular, namely, that as rates may be limited by the Government to what is regarded as a fair return upon the investment, if a part of that investment is abandoned and the stockholder is required to bear the entire loss, then taking into consideration this which he loses through abandonments the net result may be that he does not get a fair return upon his investment. Is that a fair statement?—A. Certainly, if the rate is reduced so that it is impossible for the corporation to secure anything in excess of the 5 per cent. let us say, interest on the new investment, then it would be a burden that the public would not pay and the stockholder would. May I add one word?

Q. Yes.—A. You will notice in this that you quoted from that it goes on to say that this is a very serious question and also a question of public policy, and while the classification of the commission is amply defended by accounting principles, yet it seems to gain strength, that is, in my mind, by the fact that it is at harmony with the general question of public policy, that the public is constantly

demanding improvements, and that practically—I do not say by contractual methods, but practically—in promulgating that rule the commission says to the carrier, “If you will make improvements that the public want we will not reduce your rate until, out of the increment or profit you get from the improvements, you gather enough to pay for that abandoned property.” That is the point of view, as a question of public policy, as I understand, the reasonableness of this classification rests.

Q. Is there also this distinction between a railroad corporation and an industrial company that the latter is not limited and may earn during prosperous years, ten or twenty or thirty per cent upon its investment, and then later, if the investment is lost, why, the business man, in the greater returns from his property, has come out whole, in fact, and that that condition does not apply with respect to railroads, where their earnings are limited by the Government, or may be?—A. If I understand you, you are trying to draw a distinction between a public-service industry, which the legislative body undertakes to supervise, and one that is not supervised?

Q. Yes.—A. On the assumption that competition will do the work? Yes, sir; I think that is true.

Q. In other words, the owner of private property has to stand all his own losses, yet the investor in a public utility enterprise, inasmuch as his return may be limited, is fairly entitled to be exempt from bearing the loss occasioned by these abandonments?—A. Yes, sir; on the ground that he is excluded from those extraordinary profits.

Q. Now, as I understand it, the theory upon which, instead of allowing these items of so-called abandoned property to remain in the property account, you take them out and charge them to operating expenses is that they are cases of depreciation, and that the enterprise should carry the cost of full maintenance, and that as this depreciation progresses the carrier should make provision for it in advance by setting up reserves to meet this depreciation when it comes and becomes finally effective, as, for instance, in the case of an abandonment?—A. Do you mean should do so because of sound business principles or should do so under any statute?

Q. No; I am referring now to the principle involved.—A. I think if we use “depreciation” to include inadequacy for the service that may be brought under that general head of depreciation, and that where it is possible to do so it is wise to provide against that.

Q. Yes.—A. May I just add this, to get this matter as accurate as possible? Partial statements sometimes mislead. If, however, it is in the nature of the present recognition of future inadequacy; that is, the present recognition of a depreciation to take place in the future, and, in order to provide against that there is a present investment, then it seems to me that future revenues ought to take care of all of the cost of that present investment.

Q. But if there is now no added investment to meet inadequacy or depreciation which will in a sense accrue in the future, I suppose we regard it as fair that it should be paid for out of operating expenses, and a reserve should be set up in theory to meet it, and that is the justification for charging it to operating expenses?—A. Yes, sir; that is one justification for charging it to operating expenses.

Q. Well, that is the underlying principle, is it not, upon which we regard it as proper to make those charges to operating ex-



penses?—A. Yes, sir; if you confine your consideration to the operating accounts. There are other considerations if you go into the financial accounts.

Q. What you mean, then, if I understand it, is, that during the ten years, we will say, when a depreciation of this kind is accruing and it is anticipated that at the end of ten years there will be some inadequacy or obsolescence or abandonment or something of that kind, the carrier, during that time, has the right to receive from the public not only a fair return upon his investment a rate which is not confiscatory, but, in addition, has the right to add something to that rate in order to accumulate this depreciation fund?—A. No, sir; no, sir; for the reason—

Q. Then if he can not add to it how can he get paid for it?—A. Because the function of the maintenance in operating expenses is to cover all dissipations of assets and if there is a wear and tear on the property or a dissipated asset that can not be covered by current repairs, although the taking care of it must be deferred to the future, it occurs year by year, and the inclusion of a charge to the account that it occurs year by year is a simple recognition, adequate recognition, of the current maintenance. The purpose of it is to collect a reserve which can be used without disturbing your accounts, when it is possible, in the operation and management of your property to take care of the thing that has occasioned this previous charge to maintenance.

Q. Now, you stated that the abandonment should not fall upon the stockholder and that it does not fall upon him under the system which you approve. If he gets nothing to compensate him in the way of added rates from the public while he is accumulating his fund to meet the loss caused by that abandonment then how is he compensated for his loss?—A. Of course, if he gets nothing to compensate him for paying all the operating expense and the maintenance charges he is operating under a deficit.

Q. We have been speaking now of this abandoned property—A. Oh, you changed, then, I see. Heretofore you were speaking of the maintenance charges prior to abandonment?

Q. Well, I have been speaking of abandonment and you stated that you did not think that the stockholders should be made to stand that loss and you thought that they were not required to stand that loss under the theory that we had a right to set up a depreciation fund out of operating expenses in advance to meet that depreciation and to have a deferred asset which they could substitute when the abandonment took place for it and that they would in that way not sustain the loss. Now, my question is, upon that theory, if they be allowed to receive only merely compensatory rates for the services they rendered during the period while they are accumulating the depreciation fund and are not allowed to add anything in order to accumulate this fund, then they do not, in fact, get paid for the loss and they stand the loss; is not that true?—A. I think not, for the reason that—

Q. Do you see any escape from it?—A. Yes, sir; because I can not conceive that it is correct to say that a carrier has compensatory rates unless those rates cover all forms of dissipated assets in the operation.



Q. Then, if I understand you correctly, what you mean is that when a compensatory rate is fixed it would be one item; if there was no anticipated abandonment of property it would be one amount; and if the corporation could reasonably expect and anticipate that it would have abandonment in the future then it would be entitled to get a higher rate in order to meet the loss occasioned by that abandonment; is that correct?

MR. NEEDHAM. I object to that question in the form in which it is put, because it calls on the witness to give his opinion as to whether or not rates should be raised. I see the position which counsel desires to present here, but whether any opinion of this witness which would call for, as a matter of right, on the part of a carrier a raise in rates that would depend, of course, upon whether or not the proposed improvements which would result in these abandonments were a wise thing to do. Now, if it is wise and there is a reasonable demand for it, they have two ways in which they can do it: They can anticipate by reserves or do it at once and get the benefit of the improvement and pay for it and during that time lower the expense of their operation and increase their traffic, and by so doing they increase their net revenues. If, on the other hand, their rates are sufficiently compensatory to allow them to accumulate and not make the improvement until the end of the ten years they will follow that as a business policy. If, again, the other is the better business policy they will adopt that. What I object to is this witness being called on to give his opinion as to when they are entitled to increase their rates.

THE COURT. I can see how the charging to operating expenses of abandoned property might affect dividends but I can not see how it might affect the reasonable rate, because the road is entitled to earn its operating expenses, anyway; the public has no right to deprive it of that or to reduce it in any way; so that if abandoned property is to be put into the operating expense account, it is put in a place where the law would permit the carrier to earn it.

MR. WICKWIRE. The point that I desire to make here is that the witness has stated that this theory of accumulating a fund in advance is the justification for the regulation attacked in this case. Now, I desire to know from him whether this abandoned property is an element in the process and is involved in it, necessarily, whereby the carrier does not have to stand the loss. That is the purport of my question.

THE COURT. Let us hear the question.

THE REPORTER (reading):

Then, if I understand you correctly, what you mean is that when a compensatory rate is fixed, it would be one item; if there was no anticipated abandonment of property, it would be one amount; and if the corporation could reasonably expect and anticipate that it would have abandonment in the future, then it would be entitled to get a higher rate in order to meet the loss occasioned by that abandonment; is that correct?

THE COURT. Well, if the witness knows what that means——

MR. WICKWIRE. Will you strike out the question?

By MR. WICKWIRE:

Q. Am I correct in assuming that you mean in your explanation that the rate which the carrier is entitled to receive in order that it may not sustain the loss must include sufficient to give to him a fair

return upon his investment, and also to provide for taking care of the abandonment?—A. Yes, sir.

Q. And if there were no abandonment, the rate would probably be less; is that correct? Does not that logically follow?—A. If it were known that there were not to be any abandonments, it would be less, yes, sir; that is, if there were no dissipation of the value of the property in the changed conditions and all that, or if there were no changed conditions, if there were no expense or dissipation of assets, of course, there would be no charge to operating expenses.

Q. Then the test is whether or not the abandonment is or should be anticipated?—A. Is or should be anticipated?

Q. Yes.—A. Yes, sir; that is the test.

Q. Is it the test when the abandonment is, in fact, anticipated?—A. Do you mean by "anticipated" that the thing really is recognized as a fact?

Q. Yes.—A. Yes, sir; that is the time when the accountant, under the accounting principles, must anticipate or make a charge to operating expense.

Q. But if it is not anticipated, then your rule requiring these charges to operating expenses does not apply?—A. If it does not exist, it does not apply; but as I understand, the anticipation is a recognition by the board of directors. Now, whether the board of directors do or do not recognize that there has been a loss going on, it seems to me it does not affect the fact. True accounting recognizes it.

Q. True accounting must have prophetic insight?—A. The accountant must always adjust his present charges on the basis of accumulated experience, and if he is a good accountant, he has experience tables with regard to all these things.

Q. And you think that the statistics which he has, based upon past experience, are sufficient to enable him to prophesy as to the future?—

A. With regard to rolling stock; yes. I would not dare say that with regard to the maintenance of way and structures.

Q. Then, you do not think it would apply to the roadbed?—A. No, sir.

Q. Or to an abandonment in connection with the roadbed; am I so to understand?—A. Would apply the principle or—

Q. That the true accountant requires it to be anticipated, and is able, from statistics, to anticipate the abandonment?—A. True accounting always recognizes that fact. The ability of the accountant to measure that with adequate care, so that in all cases he can anticipate, is another question.

Q. Then, the principle of accounting which you have enunciated requires that to be done which you state, in some cases, is impossible?—A. No, sir.

Q. Well, if these anticipations cannot always be made, then in these cases the principle requires an impossibility?—A. No, sir.

Q. Why not?—A. Not under the rules of accounting enunciated by the Interstate Commerce Commission, which allow for three alternatives, recognizing this difficulty.

Q. I am asking you about this matter, as a matter of principle, not at the moment with regard to anything that is allowed in the regulations. I am asking you now about the fundamental principles of accounting.—A. The fundamental principles of accounting would

require the recognition of the dissipation of the asset at the time that dissipation takes place.

Q. Yes; it must be recognized, of course, when it takes place, but you have gone much further than that, and you have said that it must be anticipated—A. No, sir.

Q. (Continuing.) And that cases arise in which accountants cannot anticipate it.—A. I do not think you quite understand the position taken by the commission's system of accounts. We are not anticipating in a present charge to operating expenses a future dissipation of assets. We are anticipating in the present charge a present dissipation of assets, which cannot be adjusted until the future.

Q. Well, if you had been the accountant of the petitioner in this case in the year 1900 or 1901, could you, from the statistics available at that time, have reasonably anticipated that these abandonments would occur in the year 1910 or 1911?—A. In this case?

Q. Yes.—A. But the hypothetical cases that you are asking are not at all this case.

Q. Will you please confine your answer to my particular question? You will have an opportunity to explain.—A. May I ask what the question is?

The REPORTER (reading):

Well, if you had been the accountant of the petitioner in this case in the year 1900 or 1901, could you, from the statistics available at that time, have reasonably anticipated that these abandonments would occur in the year 1910 or 1911?

A. I do not believe I could, sir.

By Mr. WICKWIRE:

Q. Now, if you were the accountant of any railroad company, could you anticipate any particular abandonment of property nine or ten years in advance?—A. Any abandonment of any kind of property?

Q. Yes. Well, of a character similar to those involved in this case. Let us confine it to that.

Mr. NEEDHAM. I wish you would explain what you mean by "similar." Do you mean anticipate a business policy that would determine that they would change their grades?

Mr. WICKWIRE. The facts of the petition here and the proof show exactly what I mean.

A. If you will permit me to reply to that, I shall be glad to answer your question. I can not answer your question if you ask a hypothetical question and then bind me down to a particular case where the hypothesis does not represent the facts.

By Mr. WICKWIRE:

Q. I am only asking now for anticipation of an abandonment of this kind in respect of any railroad by which you might have been employed ten years before.

Mr. NEEDHAM. I object to that question—"of this kind." There is depreciation that comes about in two ways. Of course, there is natural wear and tear, and that can be reasonably anticipated, as it is in the case of equipment, and it can be reasonably anticipated with reference to the roadbed; but a depreciation which comes by reason of inadequacy, which the railroad company determines, as a business policy, to meet by reducing grades or cutting out curves, of course, no

accountant can anticipate what business policy would be. Now, I say the question should state what he means by "this kind" of depreciation.

Mr. Wickwire. I think it is very clear. It is the kind involved in this case.

The COURT. Read the question.

The REPORTER (reading):

I am only asking now for anticipation of an abandonment of this kind in respect of any railroad by which you might have been employed ten years before.

A. I doubt very much if ten years prior to the abandonment for the purpose recited in Mr. Burt's report, and put in by Mr. Williams' testimony, and testified to by the witnesses—that it would have been possible or reasonable for an accountant to set up a reserve at that time; but I hope you will ask me why.

By Mr. Wickwire:

Q. Then, if your theory is based upon anticipation, which you yourself admit can not be made, you are predicated your conclusions upon some impossibility, are you not? A. No, sir.

Q. Are you not basing your conclusions upon the hypothesis that these things should be anticipated? A. Yes; but—

Q. But you have already stated that they could not be anticipated. A. Is it not necessary to give a date to your abandonment when you are anticipating it? Now, there are two ways, one is to take into consideration to-day a dissipation that is going on to-day, to provide for an investment ten years from now; the other is to just make the investment to-day and provide for future anticipation, and I understand that the case of the Kansas City Southern is that second case and not the first.

Q. Now, you could not have anticipated, could you, that even if you had believed that there would be some improvements in the future, that Mr. Burt or the engineers would advise that those improvements be made in such a manner as to involve abandonment?

A. Certainly all engineers recognize, in connection with improvements, property to be abandoned. It is always in the estimate.

Q. I am asking you whether, if you had been the accountant of the company ten years ago, you could at that time have anticipated that when some improvements were made in the future they would involve abandonments? A. I could not as an accountant, but the engineering department might. It would be wise if they would do so.

Q. Yes; but you have stated that the true principles of accounting require that an accountant shall make these anticipations. A. No. I will correct that. Of course, the accountant is not all there is of a railroad. He has to understand what the engineers are doing and everybody else; and when I said "accountant," I meant that the accounting officer of a road ought to, as an accountant, know whether or not there is any contemplated improvements, and the engineers should give him the information upon which he can do his work properly.

Q. Then, at that time, ten years ago you should have called in the engineer to give you an estimate of the amount of abandoned property which would be involved in improvements to be made ten years

in the future?—A. No; as an accountant, that would have been absurd. What I should have done, however, would be, in my report as an accountant to the executives, to call attention to the fact that the engineer had not as yet made any figures upon which he could tell whether there was a depreciation at present beyond what he has now included in his operating expenses. That, of course, is a matter of policy and goes to the president and board of directors.

Q. In other words, you would have reported to the board of directors, as an accountant, that you did not have the data upon which you had to act, according to your doctrine?—A. Yes, sir; I think that would be the rule.

Q. You would have had to give, then, a confession of your impotence to acquire data upon which you would be able to carry out your doctrine; is not that correct?—A. If I have not got facts, of course I have not got the facts.

Q. Then, you admit that to be true, do you not? Won't you please give us a frank answer to that, Mr. Adams? Is there any escape from it? Do you see any escape at this moment?—A. I know there is no escape from it, but, so far as that is concerned, the accounts provide for certain correction accounts. No set of accounts ever runs things to that fineness. Things are common sense in this world.

Q. Is it a matter of fineness, or is it a matter of substance?—A. It is a matter of fineness, and this also is true: The facts are that whenever a board of directors has in mind the making of improvements, then the engineer is called in to give the facts, and it is then a question as to how it should be treated. Now, if the board of directors does not see fit to do that but runs right up to the time when it must make the investments, the investment is involved in the abandoned property, and this question is how to get rid of that loss altogether on the part of this property which is thrown away.

Q. Yes.—A. And in that case, under the recital of facts in this particular instance—the improvement was to fore-stall a future disposition of assets—and in that case—

Q. In other words.—A. I would like to complete.

Q. I thought you had finished. Excuse me.—A. No, sir. And in that case the rules of the commission permit that the charges to operating expenses shall be made in the future as to the investment, and in that case there is no necessity of charging it to the time when the investment is going to take place.

Q. Then, if I understand it, so long as the board of directors did not have a program of improvements, there would be no opportunity or occasion for the accountant to set up a depreciation charge; is that correct?—A. "Occasion," yes, sir; "reason," no, sir.

Q. Then none would be set up, would there?—A. There would be one set up, because the accountant is restricted to recording the transactions as they occur.

Q. Now, if the board of directors inaugurated this plan of improvements in 1908, you would not, as an accountant, in the year 1910, have been required to set up a depreciation charge, according to our doctrine?—A. No, sir.

Q. Then you would not have been required to set up any depreciation charge during any of the ensuing periods?—A. Do you mean after 1908?

Q. From 1900 to 1908?—A. No; if nothing were known of the improvement prior to the time it was done.

Q. Yes.—A. And the experience of the company had been such that nothing of that kind ever had occurred before; it would not have been done.

Q. Then, inasmuch as there had been no anticipation of this abandonment from the year 1900 to 1908, the corporation could not have included during that period any depreciation sum to cover it, could it?—A. No, sir.

Q. And it could not during that period have exacted from the public any increased rate sufficient?—A. No, sir.

Q. (Continuing.) To cover that abandonment?—A. Well, hold on. I will say no, because you want me to there.

Q. I do not want you to unless it is the truth.—A. The point is this. It seems to me your question is confusing the fact of depreciation and whether or not it is recognized by a program. If during this period from 1900 to 1908 there had been, in fact, depreciation, but there had been, in fact, no charges to operating expenses, then it shows you have not been getting enough; and assuming that you just got a compensatory rate, you have not been getting enough for operating expenses. You are understating your operating expenses.

Q. But you stated there was no occasion for setting this up until the board of directors had inaugurated the program of improvement which was in 1908, according to my question, and hence there was no prior ground or even justification for setting up a depreciation charge; is not that true?—A. May I ask, Was there a depreciation prior or not?

Q. I have simply asked you this question. Do you mean whether I was to qualify my question by some different assumptions?—A. No, sir; I want to understand what you are asking, whether depreciation or whether not depreciation.

Mr. NEEDHAM. I do not think the question is a fair one of the witness. Counsel is speaking, as a matter of fact, with reference to this case, and the only depreciation in this case is the actual abandonment. Now, if the actual abandonment had not taken place up to that time, then there could be no depreciation in the sense in which the question is being asked and will be used in the argument of this case. I think the witness ought to know whether he is talking about general depreciation when, in fact, he intends to use this testimony as applicable to this case. Now, if there was no abandonment up to that time there could not be any depreciation.

Mr. WICKWIRE. He stated, if your honor please, that until the program of improvement had been inaugurated by the board of directors there would be no occasion for setting up any depreciation charge.

Mr. NEEDHAM. Unless they wanted to anticipate it, and then it would be a matter for the board to determine for itself. The accountant could not determine it. I simply want to keep the evidence clear, and that is all, so that the testimony of the witness can be properly used.

The COURT. If the witness wants to ask counsel a question in order to understand what the question is, it is proper enough for him to do so.

Mr. WICKWIRE. May the question be read, and if that is not clear I should be glad to make it so.

The REPORTER (reading):

I have simply asked you this question. Do you mean whether I was to qualify my question by some different assumptions?

The WITNESS. And I inquired whether, in your question, you assumed that there was or was not a depreciation prior to the improvement.

Q. Well, assuming — A. May I add to that?

Q. Yes. — A. The evidence, as I understand the situation and the evidence you have put in here, is to the effect that there was no depreciation at the time of the abandonment, and therefore this question as to providing against it seems to me not to fit this case, because the only place where you anticipate — if you build up a reserve against it at some future time, against the depreciation which is occurring currently, that does not apply in this case, as I understand it.

Q. Assuming, then, that there is no anticipation on the part of anybody until the board of directors inaugurates the program? — A. Again "anticipation." The fact that ought to have been recognized was, Was there a dissipating asset? Was there a depreciation? Not, Was there anticipation?

Q. I am assuming that there was no depreciation. — A. Well, as I understand it, there is no depreciation.

Q. And that the roadbed was in as good condition as it ever had been? — A. Yes, sir.

Q. Then, I take it, the time when this depreciation charge should have been set up by the accountant began at the time when the improvement was projected by the management? — A. Yes, sir.

Q. That being the time of its anticipation; that is correct? — A. Yes, sir; at the time of the improvement — at the time of the abandonments in connection with the improvement.

Q. Yes. Now, it is shown in this evidence in this case that this improvement was not decided to be made until, as I recollect, the year 1908 or 1909, and that the roadbed was in as good condition as it had ever been. Now, under those circumstances, if the depreciation is to be set up then, the company must satisfy the entire amount of that depreciation fund between the time when it begins to set up this reserve and the time of the abandonment? — A. Not under the rules of the commission.

Q. I do not mean under the rules of the commission; I mean according to the proper principles of accounting. — A. May I try to elucidate that for you?

Q. I want to know whether that is true or not. That will elucidate it. — A. There are three principles, and you have asked me one, and you are going on one, when in fact there are three.

Q. Will you please answer my question, if you can? — A. I would say no.

Mr. WICKWIRE. Please read the question?

The REPORTER (reading):

Yes. Now, it is shown in the evidence in this case that this improvement was not decided to be made until, as I recollect, the year 1908 or 1909, and that the roadbed was in as good condition as it had ever been. Now, under those

circumstances, if the depreciation is to be set up then, the company must satisfy the entire amount of that depreciation fund between the time when it begins to set up this reserve and the time of the abandonment?

A. Of course, if you wish to accumulate it all, you have to set it up between the time you begin and the time you end; yes, sir.

Q. So, applying that to the facts in this case, and assuming that this improvement was anticipated in the year 1908, and that the abandonment took place in the year 1910, it would be necessary for the company during that two years to set up that entire depreciation fund, would it not?—A. No, sir.

Q. According to the principles of accounting?—A. No, sir.

Q. I thought that was your prior statement, that the depreciation fund should be set up during the time ensuing after the anticipation of the abandonment and the fact of abandonment.—A. No, sir; I said nothing of the kind. What I said was, which possibly you mistook for that, that the charge to operating expenses ought to be made during the years when the assets are in process of dissipation. Now, these assets that you refer to in this case did not all dissipate in those two years between the resolutions of the board of directors to make the improvement and the date that the engineer moved the right of way; and Mr. Burt's report and the whole testimony are contrary to that assumption. I beg your pardon; I do not mean to argue the case. I merely wish to explain why I said no in this case. In this case, as I understand it, for example, the only reason for the improvement as recited in Mr. Burt's report is that 41 per cent of your traffic is lumber traffic, and that the lumber traffic exists there for about twenty years, so that at the end of twenty years you would have no more lumber traffic. Now, in order to keep your business, it is necessary for you to lower your grades, so that you can get into your wheat fields. It looks to me as though it is a very wise thing for this road to do, to issue the bonds and get money for this improvement. Now, in order to provide against that dissipating asset, that is in the nature of certain kinds of traffic in the future, and the principle that I tried to enunciate as an earning principle is that the road should provide for this, not from anything in the past, but out of the earnings of the future, and that the charge to operating expenses in the future years should be the balance of those dissipated assets of the future years. That does not mean that they must include the total of abandoned property in two years.

Q. You won't go that far? About what part of that total should be included in the two years?—A. Under the record in this case, none of it, because the assets do not begin to dissipate until—that is, there is nothing to charge off until you abandon the property, and that property is just as good, you say, at the time you took it up as it was in the first place.

Q. Yes; but we have assumed that two years prior to the time that the abandonment is made they anticipated that that abandonment would be made, and therefore, according to your prior statements, why should not that anticipation justify my setting up of a reserve?—A. I do not intend to be obstructive in any way, but there is a principle there. That charge to operating expenses occurs in the year when the dissipation takes place. Now, the determination of the board of directors two years from now to make an improvement does not dissipate anything. Therefore, it could not and need not



be anticipated. The rules of the commission give you three alternatives in treating this matter. One is to build up for the future where you have a current depreciation; one is where the depreciation is immediately recognized, and the other is where the depreciation is subsequent to the improvement in question. It was intended that those three alternatives should meet the three possible operating conditions, and that each alternative—it is not simply a case of how the management should take whichever it pleased—but it is intended that that analysis should meet the situation, and that the carriers could elect any one of those methods of treatment that meets the facts. Now, the Kansas City situation is, as it looks to me, the third situation.

MR. WICKWIRE. Your honor, do you wish to adjourn at a quarter to twelve?

THE COURT. Well, that is a matter to be determined by counsel. I do not object to going right along.

MR. WICKWIRE. I thought you suggested that to Dr. Needham.

MR. NEEDHAM. Of course we want to get through with this today, if we can.

THE COURT. I think we must. I do not think I can give you any more time than to-day.

MR. NEEDHAM. Very well, then, your honor, we will adjourn at half-past twelve.

THE COURT. I will adjourn now if you want to go.

MR. NEEDHAM. I think perhaps you had better go on with your cross-examination. It is very important to close it.

By Mr. Wickwire:

Q. You stated that this entire abandonment should not be charged during that two years. Is it your idea that a part of that should be imposed upon the future? A. It should be taken care of in the future.

Q. Which part of it should be taken care of out of the earnings of the two years, and which part of it should be deferred?

MR. NEEDHAM. I object to that question, because it is purely a question of business policy on the part of the company. The rule provides that they may anticipate or that they may do the work and scatter it over a period of years, the spread of it to be approved by the commission, but the determination of how much they will pay each year in the reserve or to pay in the future for something already done is a matter of business policy for the directors to determine.

THE COURT. I sustain the objection.

By Mr. Wickwire:

Q. According to the principles of accounting which you have enunciated, will you state how, under those circumstances, the amount of this depreciation, under the circumstances cited, would be taken care of; that is, how much would fall upon the two years and how much upon the future?

MR. NEEDHAM. I object to that. It is the same question.

THE COURT. The objection is sustained.

MR. WICKWIRE. It appears to me, your honor, that this is a pertinent question, if I conceive it correctly. The witness has enunciated this doctrine and the principles which he thinks justify the regulations in question. Now, I am simply endeavoring to find out what

his application of this doctrine would be, and I think that would be a practical question.

The COURT. How it should be managed?

Mr. WICKWIRE. According to the principles of accounting, if your honor please: that is what I was trying to draw out from the witness.

The COURT. How it should be managed at the time the board of directors are called upon to act would depend upon so many considerations that are not before us, and I do not see how the witness can help us at all on that proposition. I adhere to the former ruling.

By Mr. WICKWIRE:

Q. You have stated that some, at least, of the cost of this abandoned property should be borne by the future. If that item is in part a proper item against the future, why should not that part remain in the property account?—A. There is nothing to remain in the property account when the realty representing it has been abandoned, destroyed.

Q. But if the stockholder is entitled not to lose it, should he not have it stand there as something for which he is entitled either to be paid in full to-day or to receive the earning on it through the successive years? Why wouldn't it properly take care of that part remaining in the property account?—A. If it remains in the property account, then you have—that is, you mean the record of it remains in the property account?

Q. Yes; and remains in the balance sheet also.—A. Yes. If the record remains in the property account after the property itself has gone, then your property account is overstated, and that is quite another question.

Q. Your investment is not overstated, is it?—A. Yes.

Q. Did not the stockholders in the beginning pay for this abandoned property?—A. They did.

Q. And you have said that they should not lose it upon abandonment?—A. Yes.

Q. They should not lose their investment?—A. Yes, sir.

Q. And if they are allowed to have it stand in the property account as an item, then they simply receive payment for it in the future in the same way as they would for property which is not lost?—A. Yes. That controls the other side of the question, which is the public side of the question, and the question involved in reasonable rates—that is, in that case, you have actually thrown away property, but you retain in your property record a certain amount of money. Now, the courts require, as I understand it, that a reasonable rate is the rate upon the property used in rendering the service of transportation. Therefore, in the application of those rules you make good the rate upon a portion, even though you call it investment; you can not get the rate upon the property unless it is used, and this abandoned property is no longer used.

Q. Then the only way the stockholder can get paid for abandoned property, according to your theory, is by imposing the cost upon operating expenses?—A. That, I think, is true.

Q. And if, by reason of competitive conditions, he is unable to secure, through his rates, anything more than merely a fair return upon the balance of his property not abandoned, then he loses the

cost of the abandoned property, does he not?—A. Yes, sir; if the directors put up such a policy of improvement.

Q. That is the penalty which the stockholders must stand?—A. That is a penalty which the stockholder must pay, I suppose, by having a foolish board of directors. Any investment would never be put up under those conditions. Of course, that is again an assumed case that does not hit the bull's-eye. My mind is so held down to the practical things that it is hard for me to follow these introspections.

Q. Now, let us see about the foolish board of directors and the loss which the stockholder must stand by reason of that fact. It is in evidence here, undisputed, that had this improvement been made upon the original right of way, it would have cost this railroad company \$1,200,000 to have made these improvements, and there would have been no abandonment of property, and the entire amount might have gone into the property account, and the stockholders could have received earnings upon it through all time. It is also shown that by making a relocation of portions of the line the same grade, the same efficiency, and the same utility could have been acquired at a cost of approximately \$600,000. The board of directors elected to adopt the policy which would save to their stockholders \$600,000, and in doing so they adopted the method which you say should cause the stockholders to sustain a loss due to the conduct of this foolish board of directors. Now, will you state whether you think that statement applies in this case?—A. I may not understand the question. If I do, you are placing in comparison the two methods of making improvements?

Q. Yes.—A. And you are assuming in your question that if the board of directors elected to spend \$1,200,000 for doing work which they could do for \$600,000, that that fact would entitle them to a payment in perpetuity upon \$1,200,000. It seems to me that that assumption rather assumes a lack of appreciation of the verities of the situation on the part of the courts. I doubt very much if the courts would pay in perpetuity, or order the public to pay in perpetuity, for what is evidently a misappropriation of investment funds by the corporation.

Q. Then you think the action of the courts—A. Would protect the public.

Q. (Continuing.) Would force these stockholders into the position where they must stand this loss for abandoned property? Is that fair to the stockholders?—A. Sustain the loss for abandoned property? Now, on that point—

Q. Allow me to revise that question. You think that the courts would force the corporation to elect that policy which would prevent them from capitalizing their entire improvement, and would force them to throw two-thirds of the cost of the improvement upon the operating expenses?—A. I understand that that is the meaning of the acceptance of the valuations as the basis of determining reasonable rates; yes, sir.

Q. You understand, as this matter works out, Mr. Adams, do you not, that had these improvements been made upon the original right of way, according to the regulations of the commission the corporation would have added to its property account \$1,200,000, and that as it works out in this case the corporation is permitted by the regula-

tions to add only \$200,000 to the property account, although the evidence is undisputed that the results would have been equally beneficial in either case? Do you understand that? A. Yes, sir.

Q. Do you think that that is a reasonable regulation? A. Certainly; but may I still repeat, again, that if the board of directors had elected this expensive method of obtaining a result, under the present rules of practice of trying rate cases that would have been squeezed out of the account that is submitted to the court.

Q. You mean the additional six hundred thousand it would have cost to build it on the original right of way? A. I mean if the board of directors had put that additional \$600,000 in there.

Q. That would have been an improvident expenditure? A. That would have been an improvident expenditure, and could have been shown.

Q. Very well; let us assume that the expenditure upon the old right of way would have been exactly equal to the expenditure upon the new right of way, then there was no improvident conduct, was there? Six hundred thousand dollars in either case, on the old right of way or the new right of way, is the amount of money the company would have to spend to get the five-tenths of one per cent grade. Now, what do you say to that? A. I say that you have not given me all the facts. I can not see it.

Q. Assuming—A. Well, assuming it, with the emphasis upon the "assuming," then, of course, it is bound up in your question.

Q. Then, in that case, if the corporation, for the identical expenditure of money, may produce a result equally efficient by one method or the other, you regard it as proper accounting in one case that only two hundred thousand dollars may be capitalized and in the other case six hundred thousand dollars may be capitalized; is that your construction of reasonable regulations? A. My construction of a reasonable regulation.

Q. Will you be good enough to answer that question as to whether that is your construction of a reasonable regulation? A. I can not answer a question where I can not conceive the truth of the assumption. Now, that is an impossible assumption; it is utterly impossible.

Q. Let us see about that. Will you tell me what there is impossible about it? A. You have said that the same results follow.

Q. I say that the identical utility would have been attained in either case, according to the assumption. The point is that in either case you obtained a five-tenths of one per cent grade and an equally efficient piece of track. A. And it is done for the same amount of money in either case?

Q. Yes. A. And, in my judgment, that would mean that the original location was both a financial and engineering blunder, and that it ought not.

Q. Assuming that it was not a blunder? A. I can not.

Q. You can not assume it? A. I can not.

Q. Are you an engineer?

Mr. NEEDHAM. Wait a minute. I object to this question. It can not be assumed.

Mr. WICKWIRE. I simply ask him if he is an engineer.

Mr. NEEDHAM. Well, I will admit that. Here is the proposition. Assuming that they could make that on the right of way for six

hundred thousand dollars and they could make it off the right of way for six hundred thousand dollars, with a knowledge that if you do it off the right of way certain abandonments have to be charged up to operating expenses. Now, he asked him the question whether or not, under those circumstances, it would be reasonable for the board to make it off the right of way. Of course, it would be unreasonable. They would make it on the right of way, of course, in that case. It is a mere matter of argument. Now, all of this line of questioning has been based upon the suggestion of the witness that a certain policy would be unreasonable. That policy was in answer to a question which assumed that there would be no increase in traffic by the change and no reduction in operation by the change. That is a matter of argument. If the directors would order a change involving a large amount of money, which would not reduce operating expenses, and which would not increase the traffic, of course it would be unreasonable. Now, those are facts that are left out of these questions. What the witness intended to say was that if the board of directors or stockholders should order an improvement that would not reduce operating expenses or would not produce additional revenue, but would simply add to the cost, it would be an unreasonable business policy. I think everybody would agree to that. You do not need the witness.

By Mr. Wickwire:

Q. The question is, are you an engineer? A. No, sir.

Q. Are you able to determine engineering questions?

Mr. NEEDHAM. I object to the question. He has not been put on as an engineer.

The Court. The objection is sustained.

By Mr. Wickwire:

Q. Do you know that the location of a line having a maximum grade of one per cent will not coincide with a line of railroad having a maximum grade of five tenths of one per cent?

Mr. NEEDHAM. I object to that question.

The Court. The objection is sustained.

Mr. Wickwire. The witness stated, if your honor please, that this is an engineering blunder.

Mr. NEEDHAM. He has not made any such statement in the record.

Mr. Wickwire. He said that, upon the assumption set forth in that question, that if the cost of the expense upon the old location was the same as the cost of the expense upon the new location, that would be an engineering blunder.

Mr. NEEDHAM. That is not this case.

The Court. Well, he has admitted that he is not an engineer. You now ask him whether a one per cent line would coincide with a five-tenths of one per cent line. Do you think there is any testimony needed to demonstrate that fact?

Mr. Wickwire. It seems to me, then, that the witness has no reason to say that there is an engineering blunder here.

Mr. NEEDHAM. He has not said that.

Mr. Wickwire. I would like to have him modify his statement, if I can examine him.

Mr. NEEDHAM. He said, on your statement, if it would cost the same, six hundred thousand dollars, that would be an engineering blunder.

Mr. WICKWIRE. Yes.

Mr. NEEDHAM. But in this case it would cost twelve hundred thousand dollars as against six hundred thousand dollars. Now, he said to take twelve hundred thousand dollars when he might do it for six hundred thousand dollars would be a blunder. It seems to me it is carrying the cross-examination far afield.

The COURT. I sustain the objection.

By Mr. WICKWIRE:

Q. In determining the relative prosperity, or lack of prosperity, of a railroad corporation, what is the account to which reference is had?

Mr. NEEDHAM. I object to that question. That is not a matter of accounting.

Mr. WICKWIRE. It is distinctly a matter of accounting.

Mr. NEEDHAM. It is a matter of financing.

The COURT. Read the question.

The REPORTER (reading):

In determining the relative prosperity, or lack of prosperity, of a railroad corporation, what is the account to which reference is had?

The COURT. The objection is overruled.

The WITNESS. I think the statement that is used for that purpose is the comparative balance sheet.

By Mr. WICKWIRE:

Q. Is that the operating account, the account to which anyone interested looks in order to determine the prosperity, or lack of prosperity, of a corporation?—A. I suppose so, because the operating account is a separate entry, the result of which enters into the balance sheet.

Q. Then you do not think that is a particularly significant part of the accounts—the operating account, the income account?—A. I supposed the most important statement was the balance-sheet statement and comparison of assets and liabilities which gives the result of the prosperity, or lack of prosperity, of the company from the beginning of its existence.

Q. You mean the most important account, but I mean the account which is designed to reflect the prosperity, or lack of prosperity, of the corporation's operations.—A. Oh, of the corporation's operations!

Q. Yes.—A. For a single year?

Q. For a single year or the entire period.—A. If it is a period of years, the balance sheet reflects it all. If it is for the current operations, either monthly or annually, it is the operating account.

Q. And the integrity of those accounts is very important in order that no one may be deceived?—A. Yes, sir.

Q. The results of the operations of railroads monthly are continually published, are they not?—A. Yes, sir.

Q. In the public press?—A. Yes, sir.

Q. For the information of the public?—A. Yes, sir.

Q. And everyone interested?—A. Yes, sir.

Q. And those are generally accepted as true, are they not, by the investing public?—A. Since 1908 I think they are; yes, sir.

Q. Any inaccuracy in those reports might cause considerable injury to either a corporation or its stockholders, might it not?—A. I think so.

Q. For instance, if an unscrupulous management should erroneously include in operating expenses items that, according to proper principles of accounting did not belong there, and those statements were published without explanation, then serious injury might be occasioned to the stockholders and to the public?—A. Serious injury in many directions; yes, sir.

Q. Yes. It is of great public importance, is it not, that the true result of a corporation's earnings be correctly set forth in its operating account?—A. Yes, sir.

Q. Attention has been called, has it not, to this fact in numerous reports of the Interstate Commerce Commission?—A. I think so; yes, sir. I can not turn to all of them, but that is the point of view upon which the commission did this work of providing a uniform system of accounts for carriers.

Q. Now, suppose an unscrupulous board of directors, for the purpose of "freezing out," if I may use that well-understood term, the small stockholders should inaugurate a plan of making improvements by changes of grade, involving large abandonments of the character which are involved in this case, and suppose the estimated cost of the abandoned property was charged to the operating expenses, as required by the commission's regulations, and no explanations were made, those public accounts might cause great injury, might they not?—A. Certainly.

Q. So that if these items for abandoned property are included in operating expenses, whatever may be the purpose of the management, whether they are doing it in the exercise of a wise judgment and in the exercise of perfect good faith, or whether it is done in bad faith, if it is done and not explained, it is likely to cause great injury, is it not?—A. Yes, sir; but may I explain the safeguarding course that is set up against that?

Q. In a moment.

Mr. NEEDHAM. I object to that. He has answered the question and has a right to make his explanation at the time the question is asked.

Mr. WICKWIRE. He has answered my question.

Mr. NEEDHAM. And he desires to make an explanation.

Mr. WICKWIRE. I think you can interrogate him in due course.

Mr. NEEDHAM. No; I submit that the witness, after asking the question and asking to explain, has the right to make the explanation.

The COURT. He can explain it.

Mr. WICKWIRE. All right.

The WITNESS. This is undoubtedly true; but Congress, when it gave to the commission the right to prescribe a system of accounts, provided also for a board of examiners whose duty it should be and whose right it should be to go into all the records and papers of the company; and, further, any monthly report or annual report that, by comparison with previous years, shows such a radical and immediate change as the one your question assumes, would raise at once the suspicion that something had occurred unusual, and following the practice of the statistical division of the commission—of the accounting division of the commission—that is immediately made the

basis of investigation. I have always assumed that one of the purposes of the board of examiners with regard to the publicity connected with the monthly and annual reports was to guard against possibility of such occurrences as you have assumed.

By Mr. WICKWIRE:

Q. Well, assuming that these charges are made in respect to abandoned property, whether there was an investigation by the commission or not, the statements of operating expenses and of net income are widely published, are they not?—A. Yes; very widely published.

Q. And is it possible for the public to know it by the explanations, or to understand these things?—A. No, sir; not immediately, but may I say this, that in the annual publications the figures that are published are the result of the examination, but it would seem to me, if I may venture one step further, that there is no likelihood that this kind of thing you suppose would occur, for this reason, that if it is a conspiracy for fraud, it would be disclosed upon these accounts, and the persons, whoever they are, that are damaged would have redress by proper legal process. May I say, further, that this system of accounts is based upon what would seem to be the usual business psychology; that is, recognizing the ordinary usual notion that control the ordinary usual business men, and they are not based upon the assumption that people would either do foolish things or criminal things.

Q. Well, the fact remains, does it not, that if these accounts were published and the public do not understand them and had no explanation, large injury might ensue?—A. Yes, sir.

Mr. NEEDHAM. Now, I object to that.

The WITNESS. May I answer the question?

Mr. NEEDHAM. Go ahead.

The WITNESS. I would like to explain this matter, if I may, as to the facts in regard to the Interstate Commerce Commission. The facts are that the monthly reports of the carriers are in duplicate. One is spread on the tables in a room provided for that purpose where they can be seen. The Financial & Commercial Chronicle has a man down here to publish them. The Bureau of Economic Research has its man here, and they are published, and there is a table in the bureau of that kind providing that information for papers. More than that, there are representatives from a large number of brokers and important bankers and underwriters, who have their agents here in Washington to study these things. Now, I submit, that it is a public scrutiny there which would make it very disastrous for a company to do this thing you supposed in your question that it is doing.

Mr. NEEDHAM. Now, your honor, I want to state my objection to you please. This is on the assumption that by conspiracy or fraud the company makes a false statement. Such an assumption as that can not be put up against the reasonableness of the rule, which is supposed to operate upon ordinary and common business integrity. If such a case arose, as Mr. Adams has already stated, it should be detected by the processes of examination without making an assumption of that kind, and following out a long line of examination on that theory that if the road had deliberately attempted to make a false statement, it would make a false statement with reference to



account it saw fit, not simply with reference to the property account, but with reference to any account. I do not think that gives any light as to the reasonableness of this rule.

**The Court.** The question was based upon the assumption that the board of directors had committed a fraud. I understand that that question has been answered, and you are now proceeding upon the assumption that the board had acted honestly.

**Mr. Wickwire.** Yes; I wish to make that inquiry.

**Mr. Needham.** Well, he is proceeding upon the theory that if they had done that and had got into the courts it would have caused a great deal of damage.

**The Court.** Read the question.

**The Reporter (reading):**

Well, the fact remains, does it not, that if these accounts were published and the public do not understand them and had no explanation of them, large injury might ensue? A. Yes, sir.

**The Court.** I will let that stand as it is.

**Mr. Needham.** That is all on the assumption that it is a false entry.

**By Mr. Wickwire:**

**Q.** Might not the same result follow even though the board was acting in perfect good faith? A. Yes, sir; I think it might. You mean might not a charge to operating expenses wipe out that net revenue?

**Q.** Yes. A. Yes; I can conceive that, as a matter of business policy, the board might regard that as wise.

**Q.** And that, where the knowledge that there were no net earnings was brought to the notice of the public or to the stockholders without an explanation of it, they might sustain great injury? A. Without an explanation, I think so.

**Q.** You think that they ought to understand it in order that they may not be injured? A. Yes, sir; and usually the carriers do, where they make a change of policy or adopt any unusual course. That is reported in the accounts, the explanation is there, and there is placed in the reports for such explanations.

**Q.** Now, do you not think that if the earnings were insufficient to bear a charge of this kind, and by reason of that fact the preferred dividend on the stock was discontinued, the discontinuance of that dividend might not cause serious hardship to the preferred stockholders?

**Mr. Needham.** I object to the question on the ground, first, that it is not within the province of this witness to give testimony with reference to the effect of such an item; and, second, it is not cross-examination.

**Mr. Wickwire.** I think it is perfectly proper.

**The Court.** The objection is overruled.

**Mr. Needham.** Exception.

**The Witness.** If the stockholders, you say, do not get their dividends that that is a hardship upon them?

**Q.** Yes. A. I think so; yes, sir. They might regard it as a hardship; I don't know. I don't know what character of instrument their certificate of preferred stock is, whether it is accumulative or not.

Q. Assuming it is not accumulative. —A. Of course, the deprivation of any man of his usual income is a hardship.

Q. Yes; and the testimony in this case shows this preferred stock is nonaccumulative. You agree, then, that it works a hardship if dividends were discontinued? —A. Upon the stockholder not having his usual income?

Q. Yes. —A. Certainly.

The Court. We will take a recess until 2 o'clock.

Whereupon at 12:30 o'clock p. m. a recess was taken until 2 o'clock p. m.

AFTER RECESS.

WASHINGTON, D. C., *December 16, 1912—2 o'clock p. m.*

The court reconvened, pursuant to adjournment.

HENRY C. ADAMS, the witness who was upon the stand at the time of the taking of recess, resumed the stand, and further testified as follows:

(Cross examination (continued):

MR. NEEDHAM. If your honor please, I received this morning this telegram, which is now referred to:

In Kansas City Southern case please produce to-morrow morning all correspondence, including letters and telegrams and copies in the commissioners' files, between Henry C. Adams and all members of all committees of twenty-five of the Association of American Railway Accounting Officers in the years 1907, 1908, 1909, and 1910, and especially those in regard to balance sheet or addition and betterments or operating expenses involving the questions of so-called abandonment of property, whether replaced or not replaced.

That is signed "Arthur M. Wickwire."

This morning I said to Mr. Wickwire that I would raise no question as to the notice to produce this. The question is as to the duty of the commission to produce its records in court when there is a provision of the statute that these records may be used in court by certified copies.

The Court. What is it that is asked for; letters?

MR. NEEDHAM. All letters in the files of the commission addressed to Henry C. Adams and all the members of all committee of twenty-five of the Association of the American Railway Accounting Officer in the years 1907, 1908, 1909, and 1910. Now, of course, there are hundreds of letters—we want to deal with this frankly—there are hundreds of letters that have passed between the commission, and, I presume, members of this committee; at least the railway officials represented by this committee, because that was the manner in which that investigation was carried on very largely. Not only were letters written and answered but these railroad companies, through their executive and other officers, came to the commission and discussed the whole matter. That was the way the investigation was carried on, it not being a controversy between a railway company and a shipper, but a question of the commission's performing its duty under section twenty. Now, Mr. Denison, on behalf of the United States—and I at that time asked him, as your honor will recollect, whether he was offering them on behalf of the United States—pro-

duced here some letters that were original letters—I did not know that they were here at the time—and offered them, as your honor will remember. Mr. Wickwire immediately objected to the offer, and your honor ruled upon that offer, so I did not at that time raise the question. Those letters, of course, are not in the record or before the court. They were offered but refused. On behalf of the commission I should have to object to the use of those original letters anyway, even if they are proper evidence—if they were considered proper evidence; they would have to be put before the court in a way provided by the statute, by certified copies, because otherwise our original records would be entirely dissipated. Now, I object, on behalf of the commission, first, to being required to produce any original copies; second, to the materiality of these letters; and, third, that a call for letters of a general description of that kind is not sufficient.

MR. WICKWIRE. If your honor please, I simply wanted to use certain letters of Professor Adams which constituted part of this correspondence, in connection with his cross-examination. An issue tendered here by the answer of the Interstate Commerce Commission is as to the consensus of opinion of the accounting officers, and the matter is not one which the petitioner has raised upon the pleadings at all; but is one which was raised by the other side, and they introduced—

THE COURT. What is the question?

MR. WICKWIRE. I beg your pardon?

THE COURT. What is the question, I say, that you say has been raised?

MR. WICKWIRE. I say, the issue—any question in regard to the action of the accountants—the issue was in no way presented by the petitioner. There is nothing in the petition which in any way relates to the consensus of opinion or attitude of this association, and I think as they introduced considerable evidence in regard to the attitude of the association it would be competent for me to call for the evidence.

THE COURT. Well, I do not think so. I do not think it is relevant on the face of the record.

MR. WICKWIRE. Well, I do not care to press the matter at all, if there is objection.

THE COURT. Of course, if there is any particular letter that the witness has written which would tend, in any way to contradict his own testimony—some private letter of his own—why, if you have it, it would be proper to introduce it on cross-examination, but you can not, in a general call of this kind, require the commission to produce all of these letters.

MR. WICKWIRE. I shall not press it, if they object to it.

THE COURT. The question here is whether this is a valid rule. If it is valid, it does not make much difference whether the commission spent a day investigating the question or not.

MR. WICKWIRE. That is the position which I take, that they have tendered this issue, and I only wish an opportunity to have the matter, as long as it has gone in, in part, before the court, to be presented so that the court will understand it.

THE COURT. I ruled out letters offered by you, and I ruled out letters offered by the other side, and this is the same character of evi-

dence. What passed between this committee of twenty-five and Mr. Adams while he was connected with the commission, I do not see has any bearing upon this issue.

Mr. WICKWIRE. I think it has none except in the cross-examination of the witness, and my purpose in asking for them was limited to that.

By Mr. WICKWIRE:

Q. You stated that you thought some injurious effects might ensue from the publication of the reports, without an explanation so that the stockholders and the public would have an understanding of the situation. That would apply, would it not, to the monthly statements, as well as to the annual reports?—A. To all statements; yes, sir.

Q. Yes. The annual reports, of course, if they contained an explanation, would not forestall any misunderstanding that might arise from the reading of the published monthly statements previously during the earlier part of the year?—A. No, sir; if there was no explanation of the monthly statement.

Q. Will you state very succinctly what you would say in this letter of explanation to the stockholders?

Mr. NEEDHAM. Well, I object to that.

The COURT. Oh, I think that is proper.

Mr. NEEDHAM. What this accountant would say to the stockholders? He has nothing to do with the stockholders.

The COURT. He says it could be explained. I think it is proper to ask him how.

The WITNESS. Any explanation which would attend a monthly report, if the carrier submitting that report thinks it proper to make an explanation, would be attached to the copy that is exposed for the public to look at.

By Mr. WICKWIRE:

Q. Will you now give us your answer to the question?—A. What is the question?

Question read by the reporter.

Mr. NEEDHAM. Well, explanation of what, your honor?

The COURT. That abandoned property had been charged to operating expenses, as I understand it.

The WITNESS. We make no explanation to the stockholders. The stockholder, like everybody else, might have his representative come and look at the correspondence and the report. The responsibility of the division of statistics in this regard is recognized, so far as attaching to the report the explanation that the carrier gives.

By Mr. WICKWIRE:

Q. What I asked was what you would state in this explanation.—A. I would not state anything in an explanation unless I were writing a report—a compilation of these reports, which would be my report to the commission. This is the explanation, as I understand it, that the carrier desires to give in order that what apparently is an unusual item, when compared with the previous report, appears in his report to the commission—

Q. Well, I am speaking now of the reports to the stockholders. You previously testified that you thought that the stockholders might be disquieted and injured, unless the matter were properly explained to them, and my question was what that explanation would be, and I have asked you to state succinctly what that explanation would be.

Mr. NEEDHAM. I object to the form of the question as assuming what the witness, as I understand it, has not testified to—that a stockholder would be injured. The counsel is making the record here by questions.

The COURT. Well, I think there was some testimony of that kind.

Mr. NEEDHAM. The testimony was that if the dividend was not paid that that might be regarded as an injury to the stockholder. We all understand that.

The COURT. The question ought to include in it the facts in this case.

By Mr. WICKWIRE:

Q. Assuming the situation presented by the facts in this case, will you state what the explanation to the stockholders would be?—A. Do you mean my explanation or what my explanation would be if I were an accountant of the carrier?

Q. Yes.—A. Which?

Q. Either one.—A. Or my explanation as an officer of the commission?

Q. Either one.—A. The commission makes no report to the stockholders whatever.

Q. I understand that; but I say, if you were preparing this explanation, what would you state in that explanation?—A. Then it must be upon the assumption that I am the accountant of the carrier.

Q. Very well. You are to make the explanation.—A. Upon that assumption, at the time of the abandonment of the property there would be an entry that this credit to the property account is due to the fact that certain property in connection with a specific improvement was abandoned and written out of the accounts.

Q. Is that all you would say?—A. So far as the property ledger is concerned; yes, sir.

Q. That would be the sum of your explanation to the stockholders?—A. So far as the property account is concerned; yes, sir.

Q. I am asking for your complete explanation.—A. Then if in this it should show—it should result—that this abandoned property charged to operating expenses extinguished net revenue, I would make an entry there to show why it was, and that this extinguishment of net revenue was due to that. Now, that is as far as the accountant would go, but I should imagine now that the executive in his report to the board would go further.

Q. But what we are asking for now is an explanation to the stockholder, so that he will understand the matter.—A. Why, that is as far as the accountant would go in his entry on his books, and in his report to the executive. Now, then it comes, as I understand it, to the point where the executive or the president of the road takes it up and explains it to the board of directors or to the stockholders.

Q. Very well. Now, will you state what would appear properly in that explanation?—A. Well, I think—in this case?

Q. Yes.—A. Reference would be made probably to the Burt report and to the theory upon which the stockholders gave their consent to take in new partners—the new bondholders—and the reasons for and show that in the long run it would be a good thing for the property. That report, I should think—or that explanation, I should think—would be in the nature of an explanation to the stockholders of the financial policy adopted by the board of directors.

Q. Is that all you would state?—A. Who am I now? You say “you.”

Q. I am asking you now, if you were preparing this explanation to the stockholders.—A. Now, I am answering as president of the road.

Q. Very well.—A. And the chairman of the board.

Q. Yes.—A. I should take the stockholders right into my confidence and explain the whole thing as well as I could.

Q. You have already said you would do that, but I ask you now to state succinctly what that explanation to the stockholders would be.—A. In this case?

Q. Yes.—A. I would send every one of them the Burt report, first; send them a report of why the money is borrowed, and why, in the long run, it would be advantageous to the stockholders to have that money borrowed, and the investment undertaken even though it necessitated the casting aside of certain property which heretofore had been used in the service of transportation.

Q. Is that all you would state?—A. Well, yes; I think that is enough.

Q. Would you make any statement to the stockholders with regard to the results of the operations during the year?—A. That would appear in the report of the accountant to the president. It would appear in the report to the stockholders; yes, sir.

Q. But you would make no further explanation of it than that?—A. You would not elucidate the operation statement?—A. Why, I do not think there is anything more to say than to explain why that policy is a reasonable policy.

Q. Would you state anything to the stockholders in regard to the results of the company's operations during the year: its receipts from its operations and its expenses in producing those receipts and the net result?—A. Well, that is always in a report to stockholders from the board; yes, sir.

Q. And that would show, would it not, upon the assumption that the operating expenses were very much greater than they had been in previous years, and that there was a greatly reduced net income?—A. If that were the case, that would show.

Q. Yes.—A. Yes, sir.

Q. And would you explain that to the stockholders?—A. In connection with the —

Q. With this case.—A. Yes; I should think it would be wise to explain why the management thought it wise to accept that second of the three alternatives instead of the third.

Q. You would state that there were three alternatives presented and would you?—A. If I wished my stockholder to understand the situation I certainly should, and they ought to understand the situation.

Q. Would you state to them that the net revenue as reflected in the income statement or the statement of operations did not ac-

rately reflect the result of the company's transactions? And by "transactions" I mean current moving or carriage of passengers and freight. — A. No, sir; I should confine myself to the truth.

Q. The net result, as shown in that operation statement, would be a great falling off in net revenue, would it not? — A. It would so appear if the financial management thought it wise to choose to apply the second alternative, and the commission had agreed that they should do so.

Q. Would you state to the stockholders that the results of the company's operations in the way of carrying freight and passengers during the year had, considered alone, yielded far more net than was shown at the foot or in the balance in the income statement? — A. No, sir; I should not.

Q. You would not tell them that? — A. No, sir; because it would not be true.

Q. Would it not be true if you consider those operations irrespective of this abandonment? — A. Yes, sir; but that would be wrong method of procedure.

Q. So that you would leave them to understand that the situation was one in which the net shown in the income statement accurately represented the result of the company's operations during the year? — A. Yes, sir; I should make a statement which showed that all the maintenance charges during the year had been included in operating expenses, including — if this were the case, including the dissipation of assets that is occasioned by carrying through a program of improvements.

Q. You think that explanation would be adequate and sufficient to meet — that explanation would be adequate and sufficient to meet the situation? — A. I should think so, provided the facts had been submitted to the stockholders at the time they consented to the improvement. I mean consented to the — well, what do you call it?

Q. To the program of improvement. — A. Yes; consented to the new bonds.

Q. Yes. — A. Consented to taking in these new partners.

Q. Well, how about a large number of new stockholders who have acquired stock since that time? Would they understand it? — A. I should think they ought to.

Q. Well, but you have stated that in order to make it clear to the stockholders they should have had a statement in regard to the matter at the time the program of improvement was inaugurated. Now, if that is a necessary element in the explanation, the stockholders who have acquired stock since would not then have a complete explanation, would they? — A. If they — certainly; the new stockholders, I should think, in buying new stock subsequent to that program, might be advised.

Q. They might be, but would they necessarily know anything about it? — A. They would, if they were wise.

Q. Do you think, then, that the explanation which you have suggested would entirely meet the situation? — A. I do.

Q. Do you think the average stockholder would understand it?

Mr. NEEDHAM. Now, I object to this, if your honor please.

The Court. I sustain the objection.

By Mr. WICKWIRE:

Q. As I understand your theory, that a railroad depreciates from various causes—from inadequacy for any cause, from obsolescence, inadequacy, including inability to meet the demands of increased traffic—do you understand that this so-called inadequacy is a subdivision of depreciation or a form of depreciation? A. Yes, sir; it is. It shows that things are not up to the standard; that the old methods are not equal to the new demands.

Q. The approaching condition in which the company may require additional facilities to meet its requirements in the moving or transportation of freight and passengers is a form of obsolescence?—A. It may be so regarded.

Q. As I understand it, then, in a growing country where a railroad starts out with a relatively small volume of traffic which increases, the railroad is approaching a time when it will be unable to handle all of its business, if this increase continues, and that it must make provision to meet that condition?—A. Yes, sir.

Q. And that the ideal system of accounting requires that this should be anticipated in order to meet, as it progresses—to meet when it has progressed to a point where something must be done, the then situation? A. Do you mean to ask me if all depreciation charges must be made before any improvement is ever undertaken?

Q. No; but I wish to ascertain from you whether when a railroad is approaching a condition which you have denominated “depreciation,” the railroad should not meet that depreciation by anticipation.

Mr. NEEDHAM. Well, that, your honor, is a matter of business policy, as I understand it. Whether the railroad will meet it in that way is not a matter of accounting. The accounting system has to deal with things as they occur. If depreciation has taken place, it is recorded. If the company seeks to anticipate it, and sets aside a fund to be a reserve, why, that must be recorded, but it is purely a matter of business policy as to how they do it.

The COURT. I think I will sustain the objection.

By Mr. WICKWIRE:

Q. If the inadequacy does not require any immediate remedy, but is progressive and will ultimately require a remedy by reason of the fact that the depreciation has reached a point where the company must do something to meet the situation and to carry on its business, that, I take it, is a form of depreciation which should be met by setting up a reserve?

Mr. NEEDHAM. I object to that. That is a question of business policy.

The COURT. The objection is sustained.

By Mr. WICKWIRE:

Q. Applying this rule as to depreciation or inadequacy to a case of inadequacy arising through inability to handle an increased volume of business, it is your position that provision should be made in anticipation of the time when the facilities will finally be inadequate to handle the increased volume of traffic?

Mr. NEEDHAM. I object to that for the same reason.

The COURT. Objection sustained. He is not on the stand as an expert in railroad management.



Mr. WICKWIRE. Well, I was endeavoring to get from the witness an explanation of the theory which he stated in considerable detail as to abandonment and the ideal system of accounting. Now I am simply asking of him whether his definition of abandonment covers the case which I have referred to in the question.

Mr. NEEDHAM. Accounting deals with facts and the accountant is not responsible for the facts. The business management is responsible for the facts.

The COURT. The court will sustain your objection.

By Mr. WICKWIRE:

Q. Suppose it could be reasonably computed that in ten years the company—the volume of business would so greatly increase that the company would be unable to accommodate it with its present facilities. Would you regard that as a case of depreciation?

Mr. NEEDHAM. I object to that. There is no claim that that would be depreciation.

The COURT. Objections sustained.

By Mr. WICKWIRE:

Q. Your position that the estimated cost of replacing the portions of the line involved in this case which are no longer in use is based upon the theory that there is depreciation owing to this abandonment.

Mr. NEEDHAM. I object to that.

The COURT. The objection is sustained.

The WITNESS. That is also contrary, if I remember rightly, to the language of the classification as promulgated.

Mr. WICKWIRE. In order that we may have a clear understanding of how this matter would be set forth in the company's balance sheet, in order to represent the results of the accounting in the manner required by the regulations, I show you a page upon which are set forth some statements of balance sheets in the form of a chart [handing paper to witness] and I will ask you with respect to this chart how the balance sheet would stand under the following conditions. Suppose a corporation had no surplus and that it had borrowed upon its bonds the sum of \$600,000 and that it had received the cash from those bonds—we will eliminate for the purpose of simplicity the statement of the assets and the statement of the property account and of the capital stock which we assume to be equal—does this balance sheet "A" set forth upon this chart correctly represent the balance sheet as it would then stand?

Mr. NEEDHAM. Just let me see that, please.

Mr. WICKWIRE. Yes. Here is a copy [handing paper to Mr. Needham]. And here is a copy for your honor [handing paper to the court].

The WITNESS. This is a construction company, not an operating company?

By Mr. WICKWIRE:

Q. No; any company. —A. Well, then, you have got to take something to start with—some property to operate.

Q. Well, I have assumed that we had property and capital stock, and for the purposes of simplicity in the assumption I am eliminating those items from both sides. They would make no difference in

the net result. —A. Wherever you have a credit then to something that does not exist that is represented by a minus quantity.

Q. I do not know what you mean by that. I do not know of any thing that does not exist. There is no assumption in my question that there is something which does not exist. —A. Then you are starting out without any property. You are going to build something?

Q. If you wish to, we can add to this assumption property on one side and on the other side we can add capital stock as a liability, each of one million dollars, but that would make no difference in the result which I wish to illustrate. Does this balance sheet "A" correctly reveal the situation which would be presented? —A. You have sold your bonds, so on the asset side you have six hundred thousand dollars in cash, and on the other side you have a liability of six hundred thousand dollars. I should think that would be correct.

Q. That is correct, is it? —A. The cash is the proceeds of the bonds?

Q. Yes. —A. That is correct.

Q. That is substantially as it would appear? —A. Yes, sir; that is correct.

Q. Now, then, suppose the corporation should expend this six hundred thousand dollars of cash in the making of improvements would the balance sheet be then correctly representative of the situation? —A. There are no discounts? Dollar-for-dollar transactions you mean?

Q. Exactly. —A. Yes.

Q. Now let us assume that this company had operations from which it received an income of one million dollars and had operating expenses amounting to six hundred thousand dollars, leaving four hundred thousand dollars of net, and that this four hundred thousand dollars was in cash, does, then, balance sheet C correctly represent that situation? —A. No, sir.

The CORR. I suppose this word "expanded" ought to be "expended"?

MR. WICKWIRE. Yes, "expended." That is a typographical error. Correct that, please.

By MR. WICKWIRE:

Q. Wherein is balance sheet C incorrect? —A. On the liability side income is not income; that would be profit and loss.

Q. Well, whatever you may denominate it. Suppose you changed on the chart to profit and loss. —A. Accumulated surplus.

Q. Then the result would be as shown in balance sheet C as you have amended it? —A. Did you ask a question, sir.

Q. Yes; I asked you. —A. Yes; the balance sheet C would then be correct.

Q. Yes. Now let us assume that the end of the fiscal year has arrived and that the corporation is confronted with the regulation of the Interstate Commerce Commission, and that according to those regulations the company is compelled to charge—is permitted to charge—to improvements only \$200,000, and that the balance must be charged to operating expenses. Then would balance sheet D correctly represent the situation? —A. No, sir; on your assumption balance sheet D is absurd.

Q. Why would not balance sheet D be correct?—A. Because the occasion for charging to operating expenses is your abandonment of the property, and your assumption is that you did not have any property to abandon.

Q. Well, the item of two hundred thousand dollars expended for improvements would be a correct statement in this balance sheet, would it not?—A. Yes; but you have already said you have expended six hundred thousand dollars for improvements.

Q. Yes.—A. And now down here in D you say two hundred thousand dollars for improvements, and there is nothing said whatever about the fact that you had previous investments to this one recorded, which gave you some property that you had been using up to the time of this improvement, which property is abandoned on account of this improvement.

Q. Well, that was all implied, that we had property at the start, and you have already shown here in balance sheet C that the company had on hand actually four hundred thousand dollars.—A. My answer is that statement D has nothing to do with statement C as you put it.

Q. Well, if the company was to reconstruct its balance sheet in accordance with the requirements of the commission, after we have arrived at balance sheet C, will you please prepare a balance sheet which would accurately show the situation on compliance with the commission's regulations?—A. There is nothing for the commission's regulations to attach themselves to after C. There is nothing abandoned anywhere, and you—

Q. I am assuming in the questions, Mr. Adams, in order that I may make it clear, that the original—that the money received from the bonds was actually spent for improvements as illustrated—simply as illustrated in the case at bar.—A. Yes, sir.

Q. And that the money was all spent in that way. Now, then, after that money has been expended, the company is informed that of the total expenditures only two hundred thousand dollars may be charged to property account, and that the rest of it must be charged to operating expenses, undersand?—A. Well, in that case, balance sheet C is not a balance sheet at all. It is simply a memorandum account, to be kept in order to make a balance sheet whenever you want to make it.

Q. Very well. It is a balance sheet that the company had drawn up up to this time, upon the theory that they had no abandoned property at the time when they complied with the commission's regulations.—A. If you add that six hundred thousand dollars to the balance sheet, that is the amount that is spent. It is the gross amount spent, and also the net amount spent. If you will assume that there is property abandoned in between C and D, then we can get it straight.

Q. I have assumed that throughout.—A. Well, it is not here.

Q. I simply eliminated that on both sides. If we had one million dollars on each side of the account, it would not affect the result at all.—A. Yes, it would affect it in this way. You have put in six hundred thousand dollars expended in a balance sheet and it does not belong in a balance sheet unless it is actually expended for an improvement. You have six hundred thousand dollars more than you had when you began. You have to take either one of the two alternatives, that there is an improvement where the gross is the net, or

where there is an improvement, all that you have a right to put into your balance sheet is the net.

Q. Now, we will assume that the company has constructed its accounts down to balance sheet C, and including balance sheet C upon this system, assuming they have a legal right to keep their accounts in that way. Now, I will ask you if you will be good enough to draft a balance sheet which will accurately reveal the situation when the company complies with the commission's regulations.—A. The commission's rules mean this—

Q. Well, I am not asking what the commission's rules mean.—A. I am going to trace it out.

Q. I simply would like to know if you will be good enough to write out a balance sheet which will show the situation as it will be in the balance sheet when this regulation has been complied with by the corporation.

Mr. NEEDHAM. That is impossible on your statement here.

Mr. WICKWIRE. Do you mean to say it is impossible for the Kansas City Southern to make a balance sheet?

Mr. NEEDHAM. No.

Mr. WICKWIRE. To comply with the regulations.

Mr. NEEDHAM. No; but they would not make it out in that way. This leaves out a very important item.

Mr. WICKWIRE. Well, the question is how will this balance sheet be constructed. I want to know how it will result here. The witness has told us how it must be done, and I would like to know just what items will appear on each side of this balance sheet when the regulations of the commission have been complied with.

The WITNESS. Well, if you will begin with ten million dollars of property account and ten million dollars of securities, then you sell new bonds to the amount of six hundred thousand dollars, and you therefore set up on the securities side ten million six hundred thousand dollars. There is entered, then, on the cash side six hundred thousand dollars. Now, that cash is spent in improvements, and the six hundred thousand dollars are spent, but spent in such a way that only two hundred thousand dollars is a net improvement. Therefore, on the asset side you would add but two hundred thousand dollars. Now, according to the commission's rule, the carrier is permitted to take out of revenues four hundred thousand dollars and put it back into the cash box, so that the balance sheet is ten million dollars original property, two hundred thousand dollars new property, and four hundred thousand dollars cash, and on the liability side there is ten million dollars original securities and six hundred thousand dollars additional securities.

Q. Yes. Then, as I understand it, the proper balance sheet will ultimately be as follows: Capital, ten million dollars; expended for improvements, two hundred thousand dollars.—A. That is, capital ten million two hundred thousand dollars.

Q. Yes; cash on hand, four hundred thousand dollars, making a total of ten million six hundred thousand dollars.—A. Yes; ten million six hundred thousand dollars.

Q. And on the other side of the account there will appear the following items: Capital stock, ten million dollars, bonds outstanding, six hundred thousand dollars?—A. Yes.

Q. Is that correct? A. That is correct.

Q. Now, referring to the item in the assets side of the account of four hundred thousand dollars of cash, will you please state where that cash came from?—A. That cash came from operating revenues.

Q. But if upon the assumption which we have made the gross earnings were one million dollars, and the amount expended in connection with making the revenues was six hundred thousand dollars, and there is this item of four hundred thousand dollars added to the expenses, then the income account will be completely balanced and will show one million dollars on each side; is that true?—A. No, sir.

Q. Will not the balance sheet which I now show you, or will not the income account which I now show you [handing paper to witness] correctly represent the situation? A. Well, I have already said that your analysis is incorrect.

Q. Now, how will the income account—what will be the total in the income account after this transaction has been placed on the books? A. What income account?

Q. I mean the operating expense account, the operating account. A. Yes; that is part of the operating account.

Q. Yes.—A. That is true.

Q. Yes; the operating account. Is that a correct statement of the operating account as it will finally stand [handing paper to witness]?—A. In this operating expenses you have got your four hundred thousand dollars?

Q. Yes.—A. That is true. That means that you have collected of revenues four hundred thousand dollars more than your income—than your revenue statement calls your earnings for that year.

Q. How is that?—A. I say that means that you have included in operating expenses a charge that does not mean an expense.

Q. Yes.—A. And, therefore, your net revenue, as declared from your income account, is not all of the cash that flows into the treasury.

Q. But this operating account which I show you is correct as the matter will finally stand when it is closed, is it not?—A. It is operating expenses one million dollars, revenues one million, and there is no net revenue from operations. If that is what you want, that certainly is true.

Q. Yes; that is what I want.—A. That certainly is true, but you understand, of course, that the company has the cash just the same.

Mr. NEEDHAM. You mean the four hundred thousand dollars?

The WITNESS. Yes; it has it in hard cash, and it appears in cash in its balance sheet.

By Mr. WICKWIRE:

Q. Yes. On this balance sheet D which I have amended so as to include the ten million dollars stock, that is the item shown in this balance sheet D—cash on hand four hundred thousand dollars—is that?—A. If you have made the corrections there that I suggested, that would be correct.

Q. Yes. Now, I wish to ask you where this four hundred thousand dollars of cash came from?—A. It came from operation.

Q. But your operating account is completely balanced, is it not?

A. Yes; your operating account is completely balanced.

Q. Yes. Then, if your operating account is completely balanced, how is that a correct statement, when you say four hundred thousand dollars have been derived from it?—A. Yes, sir.

Q. Then does the operating account directly reflect the situation?—A. It does.

Q. You think, then, that an account—that an item which goes into the balance sheet in the property account of four hundred thousand dollars is a proper item as coming from an account of income which is just balanced at the end of the year?—A. The four hundred thousand dollars did not come from that account. It came from the gross revenues of the company. Now, you have put into operating expenses four hundred thousand dollars more than you have actually expended. Therefore you have got the money left.

Q. But you have already said that that item came from operations; that the company had it; that the cash was there. Is that correct or incorrect?—A. The cash is collected by the sale of transportation, passenger and freight.

Q. Yes; and the company now has the four hundred thousand dollars of cash?—A. It certainly has.

Q. And that, you say, came out of operations?—A. It did.

Q. And I ask you now, does this operations statement show that fact?—A. It does. I can correct you in just a minute, if you will let me, and get you straight. It does not at all mean that what is declared from the income account or operating account as net revenue from operations means all the money they get, nor in every case where there is a charge to operating expenses does it mean an actual paying out of money. That comes into the treasury through the profits from the sale of transportation, and it stays there.

Q. Yes. Now, I will ask you just one further question—is that operating account as it now stands a true statement?—A. Yes, sir.

Mr. NEEDHAM. Now, I object to that, because that is not an operating account. It is simply a balance of an operating account.

By Mr. WICKWIRE:

Q. Well, is the balance reflected in that account true?—A. Well, when you say that, you have.

Q. Will you be good enough, please, to answer the question. I wish to ask you one question—is that balance shown there true or untrue? Will you be good enough to give me a direct answer?

Mr. NEEDHAM. I object to that question.

By Mr. WICKWIRE:

Q. Are you unable to answer the question?

The COURT. Wait until the objection is made.

Mr. NEEDHAM. I object to that, because it is not an operating expense account. He has presented him with simply two figures, one of one million dollars on the one side and one million dollars on the other side, and asked him if that is a correct operating account. It is not, of course. It is not an account. It is simply a balance. Now, if the whole account were there, it would show a million dollars received from revenues, and six hundred thousand dollars paid out in cash for operating expenses, and a charge of four hundred thousand dollars for abandoned property, for which no money is paid out, and therefore the account balances, but the cash is on hand.

Now, I say the question is entirely an unfair one—to put such a thing as that in the record, and ask him if that is an operating account.

The COURT. Well, I think I will let the witness answer it. He certainly ought to know.

By Mr. WICKWIRE:

Q. Now, will you please—are you able to answer that question categorically, as to whether or not that balance is a true balance in the operating account? I say, are you able to answer that categorically?—A. I am not able to say whether that is true or not. A thing is true or false to represent a situation. I do not know whether that represents the situation.

Q. You are unable to say now whether that is true or false?—A. I am not able to answer a question that does not give the facts so that I can have a judgment upon it. It is impossible to answer whether that is an account or not.

Q. Then the statement that you made a little while ago that that did accurately portray the balance, you now desire to modify?—A. No, sir; I do not. There is operating expenses, one million dollars, gross earnings one million. If that represents the facts, why that represents the facts.

Q. Then, does that represent?—A. It is perfectly possible to have that represent the facts, and yet have this four hundred thousand dollars go onto the balance sheet as cash. That is all that I am interested in saying.

Q. Your final position, then, is that that is an accurate balance in the income account?—A. I refuse to answer that question.

Mr. NEEDHAM. I decline to have it go in without an objection from us, because his former question, which he answered, saying it was a balance, assumed that four hundred thousand dollars had been charged into that account for abandoned property. This question does not assume that, and therefore is misleading.

The WITNESS. I have no intention, your honor, of evading these questions.

The COURT. No.

The WITNESS. I merely desire to guard against any misapprehension when one question is put and then another question following it which does not mean the same thing.

By Mr. WICKWIRE:

Q. Referring to the regulations—to the provision in the regulations whereby a charge of this character representing abandoned property may be spread over a term of years, and assuming that the amount of that charge was one million dollars, and that the corporation had net earnings from its operations of that year of one million dollars, and had no surplus, then the corporation upon complying with the commission's regulations would not be able to pay any dividend? Is that correct?—A. No, sir.

Q. It would have no money whatever in its income account applicable to dividends?—A. You say, complying with the commission's regulations?

Q. Yes.—A. The regulations of the commission authorize a spreading of that account, and that judiciously exercised will permit

the corporation, notwithstanding your statement, to spread the account so as to declare dividends.

Q. The regulations provide that that may be done if an application is made by the carrier, do they not?—A. Yes, sir.

Q. They make no provision for doing it unless application is made by the carrier?—A. I should have to refer to the text of the account for that. An option—

Q. I call your attention to paragraph fifth on page sixteen of the classification of additions and betterments, first issue [handing pamphlet to witness].—A. Yes, sir. The language is "The carrier may, if so authorized upon application to the Interstate Commerce Commission" and so forth.

Q. Yes. Now, assuming that the corporation made no application of this kind, then it would have no money whatever applicable for dividends, is that correct?—A. If it charged it all in one lump sum, it would have nothing left with which to pay dividends.

Q. Yes. Unless it has authority not to charge it in a lump sum it must do so, under the regulations?—A. No, sir. Oh, it must, under the regulations. It must present the case to the commission for the privilege of spreading the account; yes, sir.

Q. These regulations provide, Mr. Adams, that this spreading of it over the accounts is to be permitted only if application is made. Will you call my attention to any other provision? Is there anything in those regulations that requires the carrier to make application?—A. No, sir; there is not. That is the option.

Q. Yes. Now, then, if the carrier exercises the option to make no application to the commission, then is it not true that there is no net income available for dividends?—A. That is true.

Q. If, however, the corporation does apply to the commission, and obtains permission to spread this charge over a term of ten years in equal installments—A. Not ten years, necessarily. There is no mention of the time.

Q. Well, I am assuming that they asked for that, and that they are authorized to do it.—A. Oh, if they ask for ten years, and it is agreed—

Q. Yes. Then the amount charged to the income account for the first year is one hundred thousand dollars, is it not?—A. Through the ten years; yes, sir.

Q. And the net balance in the income account is nine hundred thousand dollars?—A. Yes, sir. They have elected to choose the term of ten years?

Q. Yes. Then that nine hundred thousand dollars may be paid out by the corporation as dividends?—A. You assume one million dollars operating expenses?

Q. No, one million dollars net.—A. One million dollars gross revenue?

Q. No, one million net.—A. One million dollars net?

Q. Yes.—A. Yes, sir.

Q. So the question of whether the corporation can pay a dividend or not is dependent upon whether it applies to the commission and receives the consent of the commission to spread the charge over a term of years, is that correct?—A. Yes, sir; that is correct. It must—it elects so to do, and the commission allows it, if it is proper under the circumstances.



Q. Suppose the corporation should make an application to the commission, and the commission should deny its application entirely, then the corporation would have no money at all applicable to dividends; is that correct? A. I think that is also true.

Q. You stated in your direct examination that where one piece of property was substituted for another—and I assume that you meant of the same value or utility—there was no abandonment; is that correct? A. The second property being new property?

Q. Yes.—A. Yes, sir.

Q. That might be illustrated in the case of the exchange of one office building for another equally as valuable and of the same utility. There would be then—A. Yes.

Q. There would be then no depreciation or abandonment.—A. There would be no change in the balance. I am not sure whether those two things would be connected as a single operation, or one credited and the other charged, but the net result would be the same.

Q. The net result would be that nothing would be charged off to abandonment? A. One might be charged off because totally abandoned, and the other might be charged on.

Q. But there is no true abandonment in that case, because the transaction presents no abandonment within the meaning of the regulation? A. The net result shows no decrease.

Q. And the case is not one of abandonment within the meaning of the regulations? A. May I ask do you or do you not connect the two?

Q. Certainly. It is an exchange of properties. It is assumed to be an exchange of properties.—A. Well, then there would be no abandonment.

Q. Notwithstanding the fact that the property which the company formerly had is no longer in use?—A. If the second is the substitute for the first, then the ledger account would show no difference.

Q. Yes.—A. There would be no charge in the balance.

Q. And that would be true in the case of an office building which, we will say, was carried upon the property account at one hundred thousand dollars, and it was exchanged for another on an even basis, and the new building is of equal utility, there would then be no abandonment. A. There would be no abandonment. There would simply be a record of the fact that one piece of property is given up, and the other piece is taken on.

Q. Now, let us assume that the corporation had a piece of track two miles long, upon which it had some heavy grades of one per cent or greater, and that it desired to reduce the grades upon that section of its line, and that adjacent to this piece of track was a highway located upon lower ground, and that the public authorities were willing to exchange the highway for the railroad right of way, and that the railroad company removed its tracks and ties and made that exchange for the other location upon which it could more cheaply build its reduced grade; in that case is there an abandonment within the meaning of the regulations, requiring the property to be charged off, it being understood that the highway represents an asset of equal or superior utility? A. There has been work on the original way, has there, originally charged to the property account, grading and that kind of thing?

Q. Yes.—A. Then there is abandonment.

Q. But has not the corporation received another piece of property which stands as the substitute, and within the rule which you previously stated, this being an exchange of properties of like utility; is there any abandonment within the meaning of the regulations?—

A. Certainly, sir, there is.

Q. What is the abandonment?—A. The abandonment is ceasing to use the property, which, in its construction, has occasioned a charge, as indicating an expense. The thing that is abandoned in this case—that which is given up and no longer used in the service of transportation, is the grades and levels and things of that kind that cost labor and material to make in the first place.

Q. But it is, of course, understood and assumed in the case of the office building, that there has been money expended—one hundred thousand dollars—but there was a substitution and you say there was no abandonment. Now, in this case, there has been, it is true, money expended upon the original piece of property, but the corporation is able to exchange it for another piece of property of equal or superior utility.—A. In the case of the buildings, your salvage—that is, what you sell the building for—is equal to the total value that you charge out of your property account.

Q. But in the case of the building, there is no sale, there is an exchange.—A. Oh, you traded?

Q. Yes, in both cases.—A. You have bought the new building with the old building. Really there you have salvage equal to the current value of the new building, and your salvage you use in buying your new building.

Q. Is there any salvage about it? It is a plain case of exchange, which we have assumed, and in one case there is no abandonment, and in the second case which I cited there is assumed to be equal or greater utility. Now, wherein is there abandonment in one case and not in the other?—A. I have answered the question.

Q. Is that all the answer you care to make?—A. That in the one case, in order to explain, you must assume that the trade means that you have sold your property for a hundred thousand dollars, and you have paid a hundred thousand dollars for your new property. In that case the selling price of the old property is your salvage, and that gives you cash, and then you have spent that cash for the new property and you credit your property account with a hundred thousand dollars when you sell one and you charge a hundred thousand dollars to the property account when you get the other.

Q. Now, applying that illustration to the exchange of a roadbed for a highway, assuming that the cost of your roadbed was four hundred thousand dollars and that the price which the public authorities ask for the highway is four hundred thousand dollars and they are willing to exchange with you on an equal basis—

Mr. NEEDHAM. Then you have no railroad; it is simply a highway for a railroad?

The WITNESS. Does the municipality in that case grade your highway?

Mr. WICKWIRE. We have assumed that there is another road.

Mr. NEEDHAM. Do you mean a railroad?

Mr. WICKWIRE. We have assumed that there is a road along this highway—

Mr. NEEDHAM. Do you mean a railroad?

Mr. WICKWIRE (continuing). Which, for our purposes, is of equal or greater utility than the line of railroad which we already are using.

Mr. NEEDHAM. I ask counsel now whether, when he uses the word "road"—he speaks of a highway at first—whether he means a railroad equipped and ready for use?

Mr. WICKWIRE. No; I mean a highway.

Mr. NEEDHAM. Without any railroad?

Mr. WICKWIRE. Yes.

Mr. NEEDHAM. Then they have to spend money to put a railroad on it?

Mr. WICKWIRE. Yes; but they can get their reduced grades, we will assume, for a less expenditure.

Mr. NEEDHAM. They have got to spend money to build a railroad on it?

Mr. WICKWIRE. Yes.

By Mr. WICKWIRE:

Q. Is there any abandonment in that case?—A. There certainly is. There is an abandonment that requires a credit to the property account of what has been originally charged there in grading the old right of way, but which you no longer use.

Q. Now, then, assume that the expense of reducing your grade to a maximum of five-tenths of one per cent upon the original piece of track was \$1,200,000 and that the expense of obtaining the required gradient upon the highway was \$600,000, will you now state whether, under such circumstances, if an exchange were made there would be an abandonment within the meaning of these regulations?—A. Why, there certainly would be an abandonment of the charge for the old right of way and then the question of what you should credit to your property account, representing what you gave up in the original property, and then there would be charged to the property account whatever expense is incident to this new property.

Q. Yes.

Mr. NEEDHAM. I want to object to that question and answer and have to strike it out, because it is a very adroit way of getting this witness to treat these two roads as alike. Now, they are not alike. Counsel does not assume they are alike. The old right of way has an embankment upon it with a line of rails and ties; the other has nothing of the kind. Now, he does not assume in his proposition that they are going to build an embankment on the new road and lay ties and rails and abandon the old embankment and old rails, but he simply puts the question in a form which assumes that the change is simply going to make the cost of grading less. Now, that may all be true, but the witness must understand that there is an embankment and roadbed and rails and ties which are abandoned in one case and which have to be built in the other. Then we have got the whole proposition before us.

The COURT. Read the question and the answer.

Question and answer read by the reporter.

The COURT. I will deny the motion, and let it stand.

By Mr. WICKWIRE:

Q. Then you state that there would be an abandonment because you would have to write off in your property account the replacement cost of the original right of way; is that correct?—A. There is an abandonment because you cease to use what had originally cost you a certain amount.

Q. Yes, but now you have, in lieu and in substitution and in exchange for that property, a highway which possesses equal or greater utility than the property with which you have parted.—A. Your major and your minor premise have nothing to do with each other. Now, you are talking about utility and operating results. Originally you were talking about construction accounts.

Q. I was talking about construction accounts and I assumed that you exchanged a piece of property which had cost, we will say, \$100,000 for another piece of property which possessed equal or greater utility and that you exchanged them one for the other. Now, in that case, have you not, assuming that your statement is correct, that you have abandoned the old roadbed, received in lieu and in exchange for it a piece of property which you are entitled to write into your property account at the same figure?

Mr. NEEDHAM. I raise the same objection to this question, because he speaks of it as an exchange, as though the properties were alike, as in the instance of the buildings, which he has given, whereas they are not alike. They are getting simply a right of way, but no embankment, ties, or rails in exchange for a right of way, embankment, ties, and rails.

The COURT. The objection is overruled.

The WITNESS. What is the question, please?

Mr. NEEDHAM. I except to your honor's ruling.

The COURT. Yes.

Question read by the reporter.

The WITNESS. I am unable to answer a question where the first part of it has to do with cost and the last part of it has to do with utility.

By Mr. WICKWIRE:

Q. That is beyond you?—A. Yes, sir, that is beyond me.

Q. You can not understand that one piece of property which cost a certain figure may be exchanged for another, upon which no figure has been placed, but which has equal or greater utility? You can not understand that transaction?—A. I can not make the equation unless you have both sides of your equation the same. If you will put utility in the first place and utility in the second place, I can answer it, or if you will put cost in the first place and cost in the second place, I can also answer it, but when you ask when you abandon property that costs something, and when you get utility for it, I can not answer that.

Q. Do you not understand that utility is a great element in value, and perhaps the prime element?—A. Yes, sir; but I also understand there are two kinds of value. One is physical value and the other is commercial value or the capitalization of the revenues, and I understand that those two things, as the courts recognize them in all cases, are different and must be treated differently, and your question has jumped from one to the other.

Q. Your proposition is then, if I understand it, that where an exchange of one piece of property is made, which cost the corporation four hundred thousand dollars, for another piece of property, as to which the undisputed evidence shows it to be of equal or greater utility, that you are unable to allow the second piece of property to be set into your property account at any figure whatever: is that your position?—A. In the property account at any figure whatever that represents utility, unless there is an inventory to convert that utility into cash. There is no inventory here. You have said nothing about that. I should like very much to develop that idea and show the situation here, but no question has been asked that will permit me to do so.

Q. Well, now, the question which I desire to develop is simply this: If the corporation in electing to get its new and reduced grade has, in the exercise of wise judgment, been able to save \$600 000 by making this exchange of properties, one for the other, which has the same or greater utility, you consider that that is a situation in which, under your principles of accounting, it is proper to charge off the cost of the original piece of property from the property accounts?—A. Most certainly.

Q. There is one further question I want to ask in relation to your conferences with the committee of twenty-five and with other members of the association.

Mr. NEEDHAM. Now, before that is done, the witness has expressed a desire here to make an explanation in connection with this matter that he has been interrogated about. I should like to have that explanation made in connection with the testimony which has been given, and he has asked an opportunity to explain fully his understanding of it. I think it should go in as part of the statement which has been made in answer to these very imperfect questions.

Mr. WICKWIRE. I think that is proper matter for redirect examination.

The COURT. Well, it probably is better here in connection with his testimony in the record at this point. Mr. Adams, if you desire to make any brief explanation you may do so.

The WITNESS. I merely desire to call attention to this fact, that these accounts have to do with the charges—construction charges which are reflected in physical value. Now, in this question which was asked me, the point of view was changed absolutely from the physical valuation, and I was required to compare one member of an equation that has a physical value element in it with another member of the equation that has an inventory or commercial value in it. Now, I understand that if the propriety of such a question were conceded, that it would be ever impossible for a court to show the confiscatory character of any kind of a rate, because if it were proper to add to the property account the capitalization of that net revenue which exists at any particular time, which is covered by this phrase "utility," then always that amount of property would have to be maintained. It would be called "property," and it would forever preclude any reasonable consideration—any consideration of reasonable or an unreasonable rate—and, as I understand it, that is the reason why in all of these valuation cases or cases where valuation is required the value of the property is analyzed and put in first, ahead of the cost of reproduction; and then if there be a commercial value over and above that, that is submitted as an item by itself.

By Mr. WICKWIRE:

Q. But did you not say that you did not think it fair that the stockholder should lose his investment in the case of an abandonment?—A. I do not; and that is the reason why, under the rules of the commission, the commission has made a market for that abandoned property, so that the stockholder does not lose it.

Q. If competitive conditions do not permit the carrier to raise his rates, the market that the commission has made for him—for the carrier—is a mere delusion, is it not?—A. I agree perfectly with Mr. Williams on that—that unless there is an expectation of a saving in expense or an increase of revenue it would be bad business policy to undertake any improvement that leads to this abandonment of property.

Q. By that you mean that all the benefits that may be derived from this improvement must be applied to pay the cost of the abandoned property?—A. Until that—I think it reasonable, from the public point of view, and as I understand the attempt of the courts to be fair in these matters—

Q. Yes; and your idea is that the stockholders are not entitled to the benefit of their improvement, but that the benefits that may flow from it must be applied to cover the cost of the abandoned property?—A. No, sir: I quite approve of the statement that Mr. Burt, your engineer and expert, made at page 17 of his report, where he shows as justification for the improvement that, first, there is a five per cent return—he estimates there is a five per cent return upon the eight millions of dollars and there is to be in addition to that nearly two per cent, so that the total return upon the investment is seven per cent, five per cent satisfying the investor. I would say that justifies the improvement, and I would say that two per cent excess would be the fund from which the abandoned property could be paid out, and I understand the rules of this commission to practically say that in any case before them they will not reduce the rate until the accumulation of that two per cent will write out the property.

Q. Well, if that is to be used to write off and take care of this abandoned property, then the owners of the railroad during that period are not entitled to the benefit of it?—A. They are entitled to the reasonable returns—five per cent in this case.

Q. Well, they were entitled to that before, were they not?—A. Who; the stockholders?

Q. The stockholders; yes. A. Oh, I mean the bondholders, on their five per cent bonds.

Q. Well, I mean the railroad enterprise is entitled to a rate which, we will say, is five per cent. If they were getting that before, and have no opportunity to get more, by reason of their improvements, what inducement is there to the owner of railroads to improve their property?—A. Very frequently, and, I think, in this case, the stockholders are getting less than that—I do not know, but you must understand again—you are getting pretty far into the analysis here—but you must understand that there are other interests besides the stockholders' interests that make up for these improvements—that make improvements—and these rules of the commission provide for all conditions. Now, there is, primarily, what might be termed the managerial interests, which direct the improvements.

There is a sense of necessity for progress, and if the stockholder is harmed by this improvement—taking in new partners—he will consent to it. Moreover, there is this consideration with the stockholder: He knows that competition is coming in the future, and he does not ask for an increased return above the return that he has now having, but he wants a bulwark or defense against the dissipation of these returns in the future. For that reason he will consent to the addition of new partners.

Q. By that you mean that whenever a stockholder determines to make improvements he does it simply to prevent a reduction of the dividends to which he will be entitled and that he has no chance to vote for any advancement in the return?—A. I did not say simply to prevent a reduction, but I say that is one of the considerations, and a very strong consideration.

Q. Then the stockholder, under your rule, takes all the risk, does all the work, and can get no benefit?—Is not that substantially a true statement, under your theory?—A. Why, no. He gets all the benefit that the court recognizes in a quasi public industry under the phrase of a reasonable return upon the property used in the service of the public. But he was entitled to get that before?—A. He is always entitled to it.

Q. Am I not right about that?—A. That is all he can get, but he is protected again by the price of his securities. He gets his income in one way, and when the property is hedged about and the whole thing is made a strong property as the result of these improvements, he will consent, if other people furnish the money, for other people to come in and help build up his property and protect him against these minor or ultimate dissipation of the market value of his stocks.

Q. Now, in regard to the conference at Buffalo in the year 1907, understood, did you not, that the committee of twenty-five had authority in any way to bind that association by its action: that action was purely—A. Purely recommendatory.

Q. Purely recommendatory?—A. Yes.

Q. That was always understood, was it not?—A. Yes; that was always understood.

Q. And it was also the fact, was it not, that in many matters in regard to which the association acted, in approving various classifications, they simply approved the form and not the substance?—A. I do not know that.

Q. Is it not true that there were various instances in which you referred to the association or its representatives that the commission determined upon a certain line of policy, and that the only matter that could be considered between the association and the representatives of the commission was the question of form?—A. I think so—myself, as I remember it, there were three points respecting which referred from the association.

Q. No; but will you not please answer this question?—A. No, sir; I will insist upon "yes" or "no." I will say "no, sir."

Q. Do you not know that it was thoroughly understood by the association, and was it not stated between the association and the representatives of the commission—A. At the Buffalo meeting?

Q. I am not speaking of the Buffalo meeting, but that at a good many of the meetings where action was taken, that that was the action; that the only matter upon which the committee was to act

was a mere matter of form and not of substance? A. Oh, no, sir. There was never that idea, and I do not think any of these conferences acted in that way.

Q. Did you understand that the action of the Buffalo conference was the final binding expression of opinion of that association?—A. No, sir; I was not at the Buffalo meeting.

Q. Did you assist in the preparation of the answer of the commission in this case? A. No, sir.

Q. I call your attention to this statement in the answer of the commission, in paragraph 10, that "the classification as promulgated by this respondent, as aforesaid, represents the consensus of opinion of the Association of American Railway Accounting Officers." Do you consider that the action of the Buffalo conference represented the consensus of opinion of that association? A. I think about that time that the executives had begun to discipline the accounting officers, and it showed its effect at the Buffalo meeting.

Q. At the Buffalo meeting? A. I think so; yes, sir. I was not there, but that is a mere impression of mine.

Q. Yes. A. I could not give any reason for it.

Q. And the result of the passage of those resolutions at the Buffalo meeting, you think, reflected the sentiment of the executives?—A. No, sir; I do not know that it does.

The COURT. Well, he was not there. I do not think he ought to be asked what the resolutions reflected.

By Mr. Wickwire:

Q. Well, is this your letter (handing paper to witness)? A. Yes, sir; that is my letter, but that is not my signature.

Q. It was signed by your authority? A. I think that was signed by Mr. Meyers.

Q. Mr. Meyers—he signed it by your authority? A. I think that is Mr. Meyer's signature. Yes, sir; it is my letter.

Q. Yes. A. Yes; it is my letter.

Q. You sent it out at or about its date? A. Very likely; I think so.

Mr. WICKWIRE. I offer it in evidence.

Mr. NEEDHAM. Let met see it, please.

Paper handed to Mr. Needham by Mr. Wickwire.

Mr. NEEDHAM. Now, I object to the letter, on the ground that it has reference to the Buffalo meeting, and I suppose is introduced for the purpose of giving his construction of the Buffalo meeting, and it seems to me that that is hardly in controversy here. There is no question about the Buffalo meeting. Its own records have been introduced by the other side, and we do not dispute them one way or the other. We do not undertake to interpret it in any way. This is a letter written at the time or soon after the Buffalo meeting and it purports to give some interpretation of that meeting. Perhaps your honor would like to look at it. It seems to me wholly irrelevant to the issue in this case. He was not present.

The COURT. Let me see it.

Paper handed to the court by Mr. Needham.

The COURT. The objection is sustained.

Mr. WICKWIRE. If your please, this is a letter of a representative of the commission, and the answer in this case states what the action



of the consensus of opinion of the association was, and the commission has introduced affirmatively some evidence on that point.

The COURT. Well, the association expressed its views in a resolution, did it not?

Mr. NEEDHAM. It did, your honor.

The COURT. And it is in writing in this case?

Mr. NEEDHAM. Yes; and introduced in this case.

The COURT. Well, we will not take anybody's opinion about it.

Mr. WICKWIRE. May I have an exception, your honor?

The COURT. Yes, sir.

Mr. WICKWIRE. May I inquire if it is the practice to annex to the report—to the record—exhibits which are excluded?

Mr. NEEDHAM. No. They are, as I understand it, simply identified by the reporter, and then in arguing an exception to the court they can be presented if desired. That is my understanding of it, but it should not go into the record unless it is admitted.

The COURT. The old practice—well, until the new rules go into effect, the old practice will obtain, that evidence excluded goes in as well as evidence admitted, but I have ruled in this case in accordance with the new rules, that the record may simply show the purport of the evidence excluded, so that the court, in passing upon its admissibility later, will know just as much about it as if the record were there, and as we did with the other letters—just have the stenographer mark it and make a short memorandum of that.

Mr. WICKWIRE. Will it be satisfactory that a copy of this letter be offered in lieu of the original, with the same effect?

The COURT. Well, there is no necessity for offering it at all.

Mr. NEEDHAM. That brings up the matter with reference to all these.

The COURT. There is no necessity of using this original if the stenographer will just take a descriptive memorandum of it.

Mr. WICKWIRE. Then I will ask that this be marked "Petitioner's exhibit for identification, number whatever the number is." I think it will be number one for identification.

The letter referred to, dated July 2, 1907, was thereupon marked "Petitioner's Exhibit No. 1, for identification, December 16, 1912."

By Mr. WICKWIRE:

Q. Mr. Adams, did you make the statements in an address delivered on or about November 11, 1907, before the Association of American Government Accountants, set forth in this paper, which I now hand you [handing paper to witness]?

Mr. NEEDHAM. Do you offer this for the purpose of contradicting the witness? I do not know what it is—or do you offer it as independent evidence?

Mr. WICKWIRE. Yes; as bearing upon his cross-examination.

Mr. NEEDHAM. For the purpose of contradicting the witness?

Mr. WICKWIRE. Yes; for the purpose of explaining and qualifying his views and position.

The WITNESS. I think this is probably a correct copy of a stenographic report of some remarks I made before this association of Government accountants; yes, sir.

By Mr. WICKWIRE:

Q. This represented the views you then entertained?

Mr. NEEDHAM. Now, one moment. Let us dispose of this matter if you are going to introduce it. Do you propose to introduce it?

Mr. WICKWIRE. Yes.

Mr. NEEDHAM. Then I would like to look at it a moment.

The WITNESS. It is in the brief.

Mr. NEEDHAM. Now, your honor, I object to this as being not an official act by Mr. Adams as an employee of the commission but, as it has been described, an address which he voluntarily made outside before an association, which is introduced undoubtedly for the purpose of attempting to state the attitude of the commission. Now, the attitude of the commission with reference to a system of accounts cannot be established by what some officer of that commission says at a public meeting in a public address.

Mr. WICKWIRE. Well, do I understand that the introduction of this paper is objected to?

Mr. NEEDHAM. Yes.

Mr. WICKWIRE. I have no desire to press it if either you or the witness object to it.

Mr. NEEDHAM. I object to it.

The COURT. The objection is sustained.

Mr. WICKWIRE. That is all.

Redirect examination by Mr. NEEDHAM:

Q. Mr. Adams, your attention was called, by way of illustration, to an exchange of an office building for a new one. In answering that you assumed that the building obtained in the exchange by the railroad company was fully equipped and ready for use, like the one that was given for it, did you?—A. I think that is a natural assumption. I did not think of it.

Q. Well, was that your assumption in answering the question?—A. I do not think I thought as far as that. My thought was simply the exchange of like property for like property.

Q. Well, in using the word "like" did you understand by the use of that word that the new property obtained was ready for occupancy without the expenditure of any money upon it, so far as structural changes are concerned?—A. I did not think either way about that, or whether it was furnished or not—do you mean—

Q. I did not say "furnished." I say so far as the structural part of the building was concerned, you thought it was ready for occupancy?—A. So far as either is concerned, that they could be substituted one for the other.

Q. And substituted without the expenditure of money for structural material?—A. Yes.

Q. Now, with reference to the exchange of a railroad right of way, ready for use, for a highway, it would be necessary to construct upon the new right of way an embankment and a railroad; that is, rails and ties, before it could be used.—A. Yes, sir.

Q. And, in that respect, the two illustrations are entirely different. Now, in making that new construction, what would be charged to property account as newly acquired property?—A. There would be charged the expense of bringing the highway in condition for use.

Q. As a railroad?—A. As a railroad; yes, sir.

Q. And what would you charge out as abandoned?—A. You would charge the cost of the old line, less the salvage.

Q. Yes. What would you do with the right of way, assuming that in the case of the right of way abandoned, the title was held in fee?—A. That would be transferred to the real estate account.

Q. Suppose it was simply an easement, the same as the highway for which the exchange was made?—A. Then if any original entry for that easement was in the property account, that would be credited. If not, there would be no entry at all.

Q. Yes. Now, you have been asked whether the charging of abandonment to the operating expenses would operate as a hardship in case no dividend was paid. What did you mean by the use of the word "hardship"?—A. I understood the question to be "what would be the hardship to the owners of the preferred stock." It would be a hardship in that they would not have a dividend, whereas, before, they had one.

Q. Assume a case where the preferred stock was entitled to a dividend as earned up to five per cent and a dividend of three or four per cent only had been paid; that by a program such as was adopted in this case, it might result in passing a dividend for one or two years, and then by the reduction of the operating expenses, and the increase in business, it would result in the payment of a full five per cent dividend, would you regard that as a hardship?—A. Why, in the sense that I gave it, it would be a hardship to have your dividend go from five per cent to three per cent. It might be wise to allow that to be done for some future benefit; that might be good business policy; but confining my answer to the proposition, as I understood the original question, it is a hardship to have the income cut off to the individual, but it certainly might be good business policy to consent to having it cut off, if future benefits are to be received.

Q. There would be no more hardship in that case than there would be if the revenues had, from any other cause, been reduced?—A. Not at all.

Q. And the dividend had been passed; and that is what you meant by "hardship" is that the dividend would be passed?—A. That is all.

Q. Now, you have used the word "injuries"—that the report would be injurious, in case the stockholders did not understand or the public did not understand that the reduction was caused by an abnormal charge like the charge for the abandonment of property, which pertained to a single year. An analysis of that account would show that that was the cause of the reduction of net revenues, would it not?—A. So far as the abandonment of line is concerned, yes, sir.

Q. Yes.—A. Wait. I beg your pardon. That item, under the present accounts, would be included in another item, but the explanation of the abnormal increase of that particular account would trace it to this reason.

Q. Yes.—A. So that it would be disclosed by the entry and the explanation.

Q. Those accounts and reports, monthly and annual, are made up by the management of the corporation, are they not?—A. Yes, sir.

Q. If, upon the examination in the manner you have stated, it is discovered that errors have crept in from any cause to the reports is made, and they are corrected, which appears in the final annual report published, the corrected statement or the report first made?—

A. The corrected statement; but both statements are in the report as sworn to, so that you have both statements, one in one ink and one in another; so that the report that is sworn to if ever used thereafter shows the original entry and the corrected entry.

Q. Do you mean to say that you make some memoranda upon the original report as made, where it is covered by a second part, that there was an error? A. There is a very complete record of all the correspondence kept, as will be seen by examining the index page at the back of the report, and anything which is entered in that report upon the authority of the office is in a different colored ink—a green ink—so that it is never confused with the entry that the carrier originally submits.

Q. Suppose that in this case the Kansas City Southern had made a report, without any explanation upon it, that their operating expenses were charged this year with abandoned property occasioned by the change of the line for the purposes mentioned, and the commission had observed this unusual rise in the operating expense and had investigated it, and the company afterwards made a second report with memoranda showing that the operating expenses had been charged with this unusual item, would any memoranda be made then upon the first report, giving this explanation? I mean the first report on file in the office of the Interstate Commerce Commission. A. Yes, sir; by one of the two or three methods that are adopted. In this particular case an explanatory memorandum would be attached to the report at that point in the report, so that no one could ever see the report thereafter unless they had that memorandum before them.

Q. So that there is a complete provision for taking care of any accidents growing out of mistakes of any kind in the permanent record which is kept of these reports? A. I think so; yes, sir.

Q. In the formulation of these classifications, and more particularly with reference to the charging out of abandoned property to the operating-expense account, was there, so far as you were concerned or so far as you know, any purpose to make the representation of the facts stated in the accounts unfavorable to the weaker roads? A. No, sir.

Q. You have spoken in the course of the cross-examination of making the public pay for these improvements by charging these items of abandoned property into the operating expense, and you explained that; and now, is there any other matter that occurs to you as an accountant that justifies that method of treating the abandoned property other than allowing the railroad to continue its rates and thereby collect pay for the abandoned property from the public? A. None beyond that which, as I think, was included in my answer to the court, that it seems necessary in order to prevent, so far as accounts can prevent, the payment of dividends out of capital.

Q. Will you not explain now just how that could occur, if the item of abandoned property remained in the property account, we will say, first? A. If it remained in the property account, there would be—if it remains in the property account, the evil is that there is in the property account more property than there is used actually in transportation. Now, if no credit is allowed—in fact, there has been an abandonment of property. Now, if there is a credit made to the property account on account of that abandoned property, then it must

be charged out either through profit and loss, the accumulated surplus, or operating expenses. Now, if it is charged out through operating expenses, it results in cash flowing into the treasury in excess of the amount that can be credited as cash—of the amount earned. Now, dividends are paid out of the amounts earned, and therefore, if there should be no charge to operating expenses, then an amount of cash equal to the property that has been abandoned would be available for the payment of dividends, and that would be the payment of dividend out of the dissipation of the property. That is, it all turns, as I understand it, upon what for so many years the courts have laid down as the definitions of profit and net revenues.

Q. Take the instance under consideration; if the abandoned property net was \$400,000 and was left in the property account, that would leave \$400,000 net operating expenses for division among the stockholders, would it not?—A. Yes, sir; there would be a real dissipation of the property, but no record made of it.

Q. The operating expenses would not bear the depreciation. The depreciation would remain in the property account and leave \$400,000 that could be used for dividends?—A. There would be an actual depreciation, but no record made of the money which would be available for dividends.

Q. How would it be if it were charged to profit and loss?—A. The same result would follow, if charged to profit and loss, only in that case it does a little deeper, namely, if charged to profit and loss there is in the accounting records no obligation to restore the abandoned property to the property account.

Q. The result, then, of charging it to operating expenses is to maintain the true status of the property, both as affecting rate making and also as affecting the securities already existing?—A. I think so; yes, sir.

Q. Take the illustrations that have been given you on cross-examination; you have already stated that if it were left in the property account or charged to profit and loss there would be \$400,000 that could be distributable among the stockholders, but if the amount representing the depreciation is charged into the operating expense, the result is, while the property has been reduced, the property account has been reduced \$400,000—the cash account has \$400,000 in it; therefore, the actual property of the company at the given time is not been dissipated in any sense?—A. That is true.

Mr. NEEDHAM. That is all.

Recross-examination by Mr. WICKWIRE:

Q. Only one question. You stated that one consideration actuating is requirement that the charge be made to the operating expense account was that otherwise the corporation on your theory would be unable to pay a dividend out of its property account. Would not the same situation, if that is the end to be attained, be reached by a charge to profit and loss, instead of to operating expenses?—A. No, sir.

Q. The corporation can only pay its dividend at the end of the year out of actual surplus; is that not true?—A. No, sir. If this is—this thing should be carried to the surplus it would not be a free surplus; no, sir. The charge to the accumulated surplus would not affect the declaration of the net revenue from operations and if there

is net revenue from operations that is the fund that can be dissipated in dividends.

Q. But I am assuming that the corporation paying this dividend has a right to pay it out of any surplus, either that accumulated in years past or that which has been received during the current year; the total goes in to make up the surplus at the end of the year, and that, I understand, is the total available for dividends. Now, then, if you reduce that by a charge for the abandoned property, the effect is exactly the same whether it is taken out of earnings or out of profit and loss, is it not?—A. No, sir.

Q. I mean with respect to the right to pay a dividend.—A. No, sir. You, I think, fail to see that the charge to profit and loss is against a surplus accumulated from past years. The payment of dividends out of the current operations is quite another thing, and this charge to operating expenses is a charge against the revenues of the current year.

Q. Yes.—A. Now, if you charge this against—if you write out the abandoned property by a charge to profit and loss, which you can do, so far as bookkeeping is concerned, it means that you are not obliged to make a charge against operating expenses, and therefore, the total of the gross revenues less the amount actually spent in operating expenses is available as net revenue from operations, and is available for distribution in dividends.

Q. Yes, but the net amount which the corporation has when it pays a dividend is the amount that it has in its accumulated surplus from past years and the amount of net that it has from its operations for the current year, and the two together make the sum total. Suppose it is a million dollars. Then the corporation has a million dollars that it can distribute as a dividend. If the operation expenses—if this charge of four hundred thousand dollars is made to the profit and loss, the balance is \$600,000 payable to dividends. If the charge is made against current operations, it reduces current operations \$400,000, and the net amount of the current income and surplus then left is exactly \$600,000; isn't that true?—It must be true.—A. Why, no, sir; it is not true.

Q. State wherein.—A. There is this distinction. I think what you fail to appreciate is this: That according to the accounting principles and also the rules of courts in this matter a dividend must be paid out of what is earned, and if you now make a charge of \$400,000 to operating expenses it is a recognition that that is to be excluded from your net revenue from operation. Now, you can only pay a dividend from your net revenues.

Q. Of the current year?—A. Yes, sir; of the current year.

Q. Do you not understand you can pay a dividend from accumulated surplus?—A. Yes; you can pay a dividend from accumulated surplus, but if now you have got this \$400,000 in cash flowing in there quite independently of the net revenues from operation then there is no way of interpreting the meaning of that except that it is in fact a reserve for the restoration of your property. You can not pay it out in dividends, because it is committed to the further improvements, to fill up the hole in your assets that is occasioned by the abandonment of the property.

Q. Suppose you have net income from operation of four hundred thousand dollars, and a surplus of six hundred thousand dollars, making a total of \$1,000,000. If this charge is made to operating expenses, you then have no net from operations and the surplus is just what you had before—the year before—namely, \$600,000, and that is the amount available for dividends. Now, then, if instead of making the charge to operation, you charge the four hundred thousand dollars to your accumulated surplus, reducing it to \$200,000, and then you have \$400,000 in your net from operations, you still have \$600,000, and the total available for dividends is the same in either case; is not that true?—A. No, sir.

Mr. NEEDHAM. Take the actual case here, as near as we can state it; \$600,000 was borrowed to make these improvements.

Mr. WICKWIRE. Mr. Williams suggests that possibly the witness has not understood the question, in that he has had, perhaps, in mind the idea of a dividend which is payable only out of current income.

Mr. NEEDHAM. Oh, no. That is not the proposition at all. I think if you will allow me to ask him a question—I understand just the proposition he is getting at.

Mr. WICKWIRE. Very well.

Redirect examination by Mr. NEEDHAM:

Q. If this \$600,000 had been borrowed for the purpose of making improvements, and \$200,000 had been expended for such improvements, and there was \$400,000 net of that cash remaining, that \$400,000 could not be used for dividends, could it, Mr. Adams?—A. No, sir.

Q. It would be carried on hand and would be reflected in the final statement, but it would be carried as cash that could not be used for the purpose of dividends; is that right?—A. That is correct.

Q. Now, suppose the \$600,000 had been expended, and \$200,000 had been charged to the property account and \$400,000 had been charged to operating expenses, that would still leave the same amount—\$400,000—received from current revenues, which would represent the balance of that \$600,000, would it not?—A. Yes, sir.

Q. And that \$400,000 would be just as sacred from the payment of dividends as in the former case, which I have given you?—A. Yes, sir.

Q. That is correct, is it?—A. Yes, sir; that is correct.

Q. Now, when you say that could not be used, you mean it has gone into that account and must be used for improvements?—A. I mean—perhaps, to make it clear, I might say that I mean the same thing which I understand the brief in this case means, when they say that this must be restored to the bond account.

Q. But let us have it understood distinctly. If \$400,000 of the original \$600,000 remained there no dividends could be paid out of it. There is no question about that, is there?—A. That is correct.

Q. Now, if \$400,000 had been charged to the operating expenses, no money being taken out of the revenues for that item, that \$400,000 would go as representing the amount appropriated of \$600,000 for improvements, would it not?—A. Yes, sir.

Q. Yes. And that could not be used for dividends?—A. It could not.

Q. Let me put it just once more, because I want to be sure we are right. Suppose the net revenues of the company were a million dollars, represented in cash in the treasury; that \$600,000 had been spent for improvements; that \$400,000 of that is charged to operating expenses for abandoned property. The result of the bookkeeping would be that \$600,000 of that million dollars could be used for dividends, or would go into the general free profit and loss account, which could be so used, and \$400,000 of it would go into an account or be represented in an account which could not be used for dividends, is not that true?—A. I so understand it.

Recross-examination by Mr. Wickwire:

Q. Just a question. In case the company complied with the regulations of the commission, there would be \$400,000 which would have to be restored to the bond account, would there not?—A. I think—yes, I think that is a reasonable way to put it. Have it restored to the bond account and then that is merely a recognition of the fact that its destination is to improve the property, so that ultimately for whatever amount of new bonds you issue you have got an increase of your property to that amount, which validates your securities.

Q. I was looking for those charts that I had. Have you those charts? I simply want to introduce them in connection with the record.—A. These [exhibiting papers]?

Q. Yes. [Papers handed to Mr. Wickwire by the witness.]

Mr. Wickwire. I offer in evidence the papers used in connection with the illustration of the balance sheet, and ask that they be marked petitioner's exhibits with appropriate numbers. Have you any objection to these?

Mr. NEEDHAM. Have you corrected that?

Mr. Wickwire. Yes; I think so.

Mr. NEEDHAM. If it is corrected I do not object to it.

Mr. Wickwire. These are correct, are they not, Mr. Adams?

The Witness. Yes; I think so.

Mr. Wickwire. That is all, Mr. Adams.

Mr. NEEDHAM. That is all.

The two charts so offered and identified were received in evidence and thereupon marked, respectively, Petitioner's Exhibits Nos. 12 and 13, December 16, 1912.

PETITIONER'S EXHIBIT NO. 12 (COMMERCE COURT DOCKET NO. 561).

BALANCE SHEET A.

Assets:		Liabilities:	
Cost of property	\$10,000,000	Capital stock	\$10,000,000
Cash on hand	600,000	Bonds outstanding	600,000

BALANCE SHEET B.

Assets:		Liabilities:	
Cost of property	\$10,000,000	Capital stock	\$10,000,000
Expended for improvements	600,000	Bonds outstanding	600,000



## BALANCE SHEET C.

Assets:		Liabilities:	
Cost of property	\$10,000,000	Capital stock	\$10,000,000
Expended for im-		Bonds outstanding	600,000
provements	600,000	Income, accrued sur-	
Cash on hand	400,000	plus	400,000
	11,000,000		11,000,000

## BALANCE D.

Assets:		Liabilities:	
Cost of property	\$10,000,000	Capital stock	\$10,000,000
Expended for im-		Bonds outstanding	600,000
provements	200,000		
Cash on hand	400,000		
	10,600,000		10,600,000

PETITIONER'S EXHIBIT NO. 13 (COMMERCE COURT DOCKET NO. 56).

## INCOME ACCOUNT.

Operating expenses	\$1,000,000.00	Gross earnings	\$1,000,000.00
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MR. WICKWIRE. I just have a very few questions to ask of Mr. Nay, and then I am through.

FRANK NAY was called as a witness, and having been first duly sworn testified as follows:

Direct examination by MR. WICKWIRE:

Q. Assuming a case such as that presented by the petition of a reduction of grades upon adjacent ground at an expenditure of \$600,000, while it would cost \$1,200,000 to make that reduction of grade upon the old right of way, and the new locations are required solely for that purpose and the improvements, and assuming that the result is equally as good in point of utility upon the new locations, will you state whether or not, as a matter of accounting, there is any dissipation of the assets which is required to be reflected in the company's accounts?

MR. NEEDHAM. I object to that. I do not understand that this is rebuttal.

THE COURT. Well, it is not rebuttal, but you can get through with it in a few minutes, can you not?

MR. WICKWIRE. Yes; in only a minute or two.

THE COURT. Yes. Then, let him answer.

THE WITNESS. I would say no, sir; as there is no dissipation of assets whatever, as the line still remains from Kansas City to the Gulf.

By MR. WICKWIRE:

Q. Do you consider there is any dissipation of the investment?—

A. No, sir.

Q. Or abandonment of property?—A. No, sir.

Q. Respecting the balance sheet, does that show or demonstrate whether a corporation is prosperous or not?—A. I would be unable to determine whether a corporation was prosperous or not from a balance sheet alone without other documents.

Q. The measure of prosperity of a corporation is the excess of its receipts over expenditures, is it not?

MR. NEEDHAM. I object to the question—the form of it.

THE COURT. The objection is sustained.

By Mr. WICKWIRE:

Q. Now, referring to this Buffalo meeting, you were present and were a member of the subcommittee?—A. Yes, sir.

Q. Were you the president of the association at that time or at some subsequent time?—A. I was president at that time.

Q. And you were a member of the subcommittee?—A. Yes, sir.

Q. And you are familiar with all the proceedings of the association from that time down to the present?—A. Fairly so, I should say.

Q. Well, you have had copies of the records of their proceedings?—A. Yes; of all their proceedings.

Q. And have familiarized yourself with all of its transactions?—A. Yes, sir.

Q. State whether or not that association has ever approved the regulations as to abandoned property involved in this suit?

Mr. NEEDHAM. I object to that question.

The COURT. The objection is sustained.

Mr. WICKWIRE. Well, do I understand that it is not claimed by you that the association ever did approve of a regulation?

Mr. NEEDHAM. We claim nothing except what is shown in the record, which has been introduced here. So far as the association's action is concerned, it is stated in the records which have been introduced here.

Mr. WICKWIRE. That is all.

Cross-examination by Mr. NEEDHAM:

Q. You are the same Mr. Nay who gave testimony before in this case?—A. Yes, sir.

Mr. NEEDHAM. That is all.

Mr. WICKWIRE. If your honor please, in the petition, at page thirty-one, I would move to amend the first paragraph so as to read as follows:

Your petitioner is also informed and believes, and so alleges, that the said alleged orders and classifications of the Interstate Commerce Commission require that in accounting for said expenditure of approximately \$634,183.74 made by it in revising its grades by changes of line in the manner above set forth, a charge shall be made to operating expenses and profit and loss accounts of the estimated replacement cost (less salvage) of the portions of its line abandoned in making said revisions, and that the approximate net additions to the property accounts of your petitioner in connection with said expenditure of \$634,183.74 shall be only \$234,747.74, which amount is reached through the following process of computation.

Mr. NEEDHAM. It is understood, if your honor please, that the answer of the Interstate Commerce Commission, and, I presume, the answer of the United States, will stand as to the petition as amended?

Mr. WICKWIRE. That is, of course, satisfactory.

Mr. GORDON. That is as to both the United States and the Interstate Commerce Commission?

Mr. WICKWIRE. Yes. I understand the motion is granted?

The COURT. Yes. You probably ought to furnish the clerk with copies of the amendment for the other judges.

Mr. WICKWIRE. Yes, I will do so, your honor.

Mr. NEEDHAM. I should like the record to show that the taking of testimony is closed, so we may go on with the printing of the case.

The COURT. I shall be very much pleased to make such an order.

Mr. NEEDHAM. I may say that it is with our concurrence. I understand it will go on the January docket.

The Court. I assume so. The stenographer will prepare a copy of the testimony as soon as possible, and there ought to be an original for filing with the clerk, to which I will certify if the stenographers first certify that it is a true copy.

Mr. NEEDHAM. Then the printing will be done from the record as filed with the clerk?

The Court. Yes.

Whereupon, at 4.42 p. m., on the 16th day of December, 1912, the testimony in the above entitled proceeding was closed.

#### STENOGRAPHERS' CERTIFICATE.

WASHINGTON, D. C., *Saturday, January 25, 1913.*

We hereby certify that we are the stenographers who reported the testimony given before the United States Commerce Court on March 5, 1912; May 6, 1912; December 10, 1912; December 11, 1912; December 12, 1912; December 13, 1912; December 14, 1912; and December 16, 1912, in the case of *The Kansas City Southern Railway Company, petitioner, vs. The United States of America, respondent*, Interstate Commerce Commission, intervening petitioner No. 56; and that the foregoing transcript of the testimony in said cause, consisting of 195 typewritten pages, as corrected by counsel for the petitioner and for the Interstate Commerce Commission, is, to the best of our knowledge and belief, a true and correct report of said testimony.

JAMES R. WICK,

H. G. WILBUR,

H. L. FRANCISCO,

A. HALLAGER,

*Stenographers.*

#### IN THE UNITED STATES COMMERCE COURT.

The Kansas City Southern Railway Company, a corporation, Petitioner,	} No. 56.
<i>vs.</i>	
The United States of America, Respondent, Interstate Commerce Commission, Intervening Respondent.	

I, WILLIAM H. HUNT, associate judge of the United States Commerce Court, heretofore designated to take testimony in the above-entitled case, do hereby certify that the foregoing typewritten pages, Nos. 1 to 70, inclusive, in volume 1, as corrected by counsel for the petitioner and for the Interstate Commerce Commission, is a true and correct transcript of the testimony of the sundry witnesses therein named; that the same was taken before me on March 5, 1912, at Washington, District of Columbia.

WM. H. HUNT, *Associate Judge.*

## IN THE UNITED STATES COMMERCE COURT.

The Kansas City Southern Railway Company, a corporation,  
petitioner.

v.

The United States of America, respondent.

Interstate Commerce Commission, intervening respondent.

No. 56.

I, John E. Carland, associate judge of the United States Commerce Court, heretofore designated to take testimony in the above entitled case, do hereby certify that the foregoing typewritten pages, Nos. 71 to 1075, inclusive, in volumes 2 to 8, inclusive, as corrected by counsel for the petitioner and for the Interstate Commerce Commission, is a true and correct transcript of the testimony of the sundry witnesses therein named; that the same was taken before me on May 6, 1912, and December 11, 12, 13, 14, and 16, 1912, at Washington, District of Columbia.

JOHN E. CARLAND, *Associate Judge*.

JANUARY 29TH, 1913.

Kan. City So. Ry. Co. v. U. S.

No. 571.

Ex.

**CLASSIFICATION**  
**OF**  
**EXPENDITURES FOR ADDITIONS**  
**AND BETTERMENTS**

**AS PRESCRIBED BY THE**  
**INTERSTATE COMMERCE COMMISSION**  
**FOR**  
**STEAM ROADS**

**IN ACCORDANCE WITH**  
**SECTION 20 OF THE ACT TO REGULATE**  
**COMMERCE**

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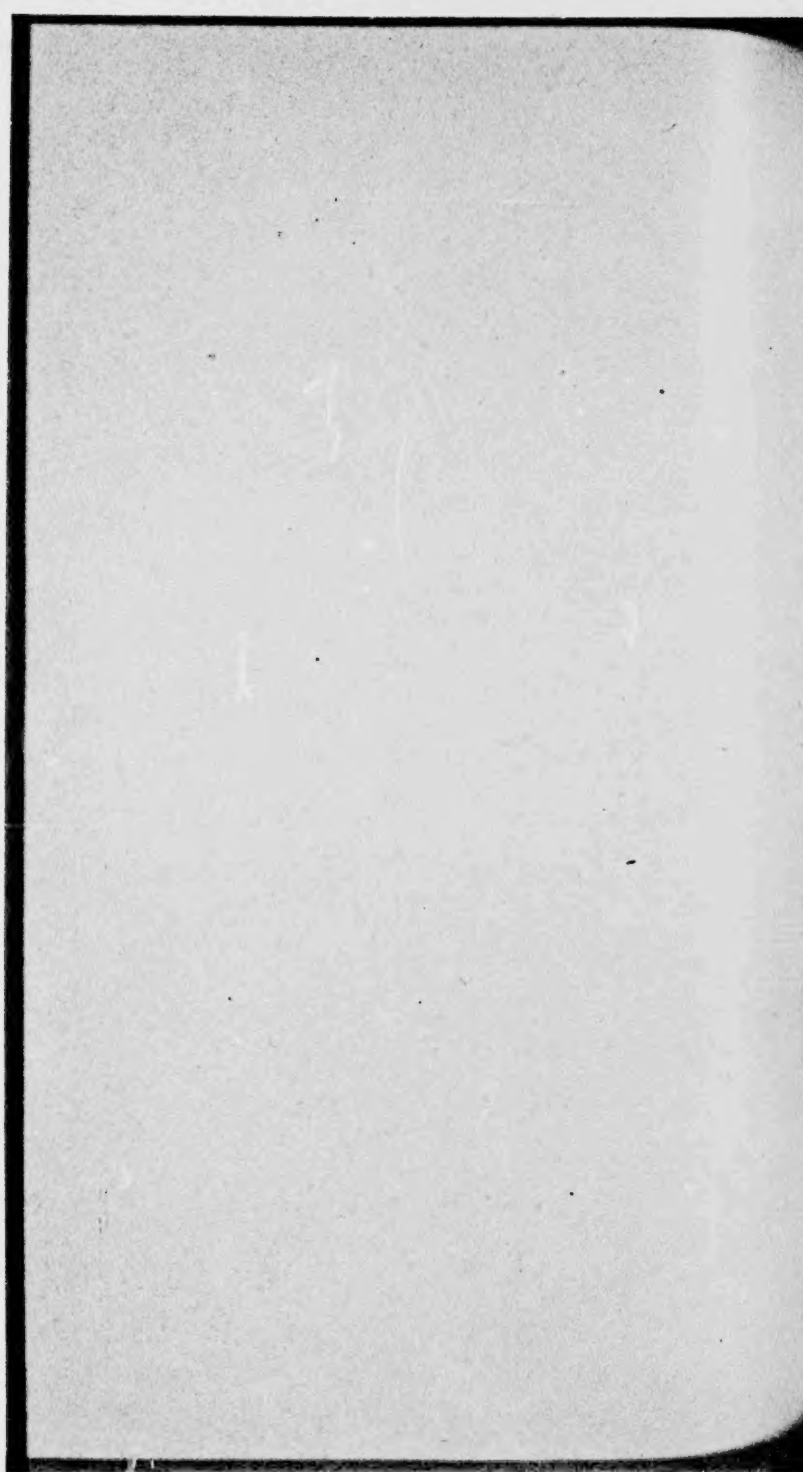
**FIRST ISSUE**

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*Effective on July 1, 1909*

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**WASHINGTON**  
**GOVERNMENT PRINTING OFFICE**  
**1909**



CLASSIFICATION  
OF  
EXPENDITURES FOR ADDITIONS  
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*Effective on July 1, 1909*

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WASHINGTON  
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1909





THE INTERSTATE COMMERCE COMMISSION.

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MARTIN A. KNAPP, *of New York,*  
JUDSON C. CLEMENTS, *of Georgia,*  
CHARLES A. PROUTY, *of Vermont,*  
FRANCIS M. COCKRELL, *of Missouri,*  
FRANKLIN K. LANE, *of California,*  
EDGAR E. CLARK, *of Iowa,*  
JAMES S. HARLAN, *of Illinois,*

EDWARD A. MOSELEY, *Secretary.*



At a General Session of the INTERSTATE COMMERCE  
COMMISSION, Held at its Office in Washington, D. C.,  
on the 21st day of June, 1909.

*Present:*

MARTIN A. KNAPP,	} Commissioners.
JUDSON C. CLEMENTS,	
CHARLES A. PROUTY,	
FRANCIS M. COCKRELL,	
FRANKLIN K. LANE,	
EDGAR E. CLARK,	
JAMES S. HARLAN,	

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

*It is ordered,* That the Classification of Expenditures for Additions and Betterments for Steam Roads and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form to be hereafter known as First Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Statistics and Accounts; and

that each of said copies so authenticated and filed shall be deemed an original record thereof.

*It is further ordered.* That the said Classification of Expenditures for Additions and Betterments with the text pertaining thereto be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of their accounts of expenditures for additions and betterments; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts of expenditures for additions and betterments in conformity therewith; and that a copy of said First Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

*It is further ordered.* That the rules contained in said First Issue of the Classification of Expenditures for Additions and Betterments are, and by virtue of this order do become, the lawful rules according to which the said expenditures for additions and betterments are defined; and that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of the accounts of expenditures for additions and betterments of any such carrier; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier or for any person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier to keep any account or record or memorandum of any item of expenditure for additions or betterments except in the manner and form in said First Issue set forth and hereby prescribed, and except as hereinafter authorized.

*It is further ordered.* That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in said First Issue established as may be required for the purposes of any such carrier or of any receiver or operating trustee of any such carrier; or may make assignment of the amount charged to any such primary account to divisions, to its individual lines, or to States; *Provided, however,* That a list of such subprimary accounts set up or such assignments made by any such carrier or by any receiver or operating trustee of any such carrier be first filed in the office of the Bureau of Statistics and Accounts of this Commission subject to disapproval by the Commission.

*It is further ordered.* That in order that the basis of comparison between the fiscal year ending June 30, 1910, and previous years be not destroyed, any such carrier or any receiver or operating trustee of any such carrier may, during the twelve months ending June 30, 1910, keep and maintain, in addition to the accounts of expenditures for additions and betterments hereby prescribed, such portion or portions of its present accounts with respect to items of expenditures for additions and betterments as may be deemed desirable by any such carrier, or by any receiver or operating trustee thereof, for the purposes of such comparison; or, during the same period, may maintain such groupings of the primary accounts hereby prescribed as may be desired for that purpose.

*It is further ordered.* That any such carrier or any receiver or operating trustee of any such carrier may, in addition to the accounts of expenditures for additions and betterments hereby prescribed, keep any temporary or experimental accounts the purpose of which is to develop economies in the construction of additions and betterments; *Provided, however,* That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed; and that any

such temporary or experimental accounts shall be open to inspection by the Commission.

*It is further ordered,* That July 1, 1909, be, and is hereby, fixed as the date on which said First Issue shall become effective.

A true copy:

EDW. A. MOSELEY,

*Secretary.*

## INTRODUCTORY LETTER.

INTERSTATE COMMERCE COMMISSION,  
BUREAU OF STATISTICS AND ACCOUNTS,  
*Washington, D. C., June 15, 1909.*

### TO CARRIERS CONCERNED:

Under date of July 5, 1907, a Tentative Classification of Additions and Betterments Expenditures, and text therefor, was issued in Accounting Series Circular No. 11. In this official promulgation of a Classification of Expenditures for Additions and Betterments, it is proper to call attention to the following differences between this classification and that tentatively issued in Accounting Series Circular No. 11:

First. The distinction between additions and betterments has been eliminated.

Second. As the Form of General Balance Sheet Statement to be promulgated by the Inter-state Commerce Commission to take effect on July 1, 1909, provides that all expenditures for new construction and for additions and betterments should be charged to the proper accounts under the caption "Property Owned as Investment," it is no longer permissible to charge such expenditures to Income, Profit and Loss, or Special Funds in such a manner as to exclude any expenditure for additions and betterments from the property accounts in the balance sheet.

Third. Accounting Series Circular No. 11 tentatively provided that when any abandonment of property occurred, whether such property was replaced by new and

improved property or not, the original cost of the property abandoned should be credited to Additions and Betterments and charged to Operating Expenses. The present classification provides that Operating Expenses should be charged only in case the abandoned property (other than land or equipment) is replaced; and the amount to be charged is now based upon *the cost of replacing in kind* the abandoned property instead of the original cost as provided in the circular.

When property (other than land or equipment) is abandoned in the course of betterment or improvement work, and the cost of replacing such abandoned property in kind would, if included in a carrier's operating expense accounts for a single year, unduly burden such accounts for that year, the carrier may, if so authorized upon application to the Interstate Commerce Commission, charge such cost to an account entitled "Property Abandoned, Chargeable to Operating Expenses," which has been introduced into the Form of General Balance Sheet Statement for this purpose. The phrase "unduly burden such accounts," used above, should not be interpreted as meaning that a carrier is at liberty to make charges for abandoned property directly to Operating Expenses, or to Operating Expenses through the account, "Property Abandoned, Chargeable to Operating Expenses," in view of its financial ability to make such charges directly in one year and its inability to make such charges in another year. It should be remembered that the charges included in Operating Expenses are designed to cover the current cost of maintaining and operating the property, and that the Property Abandoned accounts are designed to cover any unusual expenditures from year to year.

In case property is abandoned and not replaced, the original cost (estimated, if not known) should be credited to the appropriate additions and betterments accounts and charged, less salvage, to the Profit and Loss



Account, to which should also be charged the cost of removing old material and other incidental expenses directly connected with the abandonment.

A carrier may, if so authorized upon application to the Interstate Commerce Commission, set up depreciation accounts under the general account, "Maintenance of Way and Structures" in Operating Expenses, to which may be charged, during a series of years, such amounts as will provide for the ultimate retirement or abandonment of tracks and other structures described in the primary accounts under the general account named.

When a depreciation account is provided, the amounts charged to it should be credited to a reserve, and this reserve, instead of Profit and Loss, should be charged with the cost of the property (other than land or equipment) abandoned and not replaced.

The present classification provides that when land is abandoned, in the course of improvements or otherwise, the proper accounts under Additions and Betterments should be credited with the original cost of the land, and Profit and Loss should be debited or credited with the difference between the original cost and the amount realized from its sale or the appraised value at which it is to be retained as an outside investment.

The Property Abandoned account does not apply to land or equipment.

Fourth. A single account, No. 33, "Equipment," has been substituted for the several accounts formerly covering the various classes of equipment. This fact, however, does not relieve carriers from the necessity of redistributing this account in order to enable a report to be made in accordance with the detailed equipment accounts contained in the Classification of Expenditures for Road and Equipment. The text for this account provides that the cost of *all* equipment purchased, built, or otherwise acquired should be charged to Additions and Betterments without regard to replacement accruals; and that the

original cost of all equipment retired should be credited to Additions and Betterments and charged to Replacement Account at the time of retirement.

It is proper that acknowledgment should here be made to the Association of American Railway Accounting Officers, and to the Committee on Corporate, Fiscal, and General Accounts, appointed by that association, for their hearty cooperation in working out the details of this classification.

HENRY C. ADAMS,

*In charge of Statistics and Accounts*

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## GENERAL INSTRUCTIONS.

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1. "Additions and Betterments" include additional structures, facilities, or equipment not taking the place of anything previously existing, and the enlargement or improvement of existing structures, facilities, or equipment, or the proper portion of the cost of new structures or facilities of an improved or higher class taking the place of others previously existing.

2. It will be noted in this connection that provision is made in the text of account No. 33, "Equipment," that all newly acquired equipment should be treated as additions and betterments whether bought to replace other equipment or as distinct additions to the property.

3. All debits and credits to accounts provided in this Classification of Expenditures for Additions and Betterments should be reclassified in accordance with the Classification of Expenditures for Road and Equipment, it being understood that all accounts affecting additions and betterments accounts should be closed finally into road and equipment accounts.

4. Expenditures for additions and betterments amounting to less than \$200 should be charged to the appropriate accounts under Operating Expenses or Outside Operations, except as otherwise provided in the following classification.

5. In case it becomes necessary directly in connection with betterment or improvement work to abandon any property, the cost of replacing the abandoned property

in kind, plus the cost of removal but less the value of salvage, should be charged to the appropriate accounts under Operating Expenses. In case, however, the amount so chargeable is large, and its inclusion in a carrier's operating expenses for a single year would unduly burden the operating expense accounts for that year, the carrier may, if so authorized upon application to the Interstate Commerce Commission, charge such cost to the Property Abandoned account provided in the Form of General Balance Sheet Statement, or to the reserve account mentioned in paragraph 6.

6. When property is abandoned and not replaced, the original cost (estimated, if not known) should be credited to the appropriate additions and betterments accounts and charged, less salvage, to Profit and Loss Account, to which should also be charged all incidental expenses directly connected with the abandonment. If so authorized upon application to the Interstate Commerce Commission, however, a carrier may set up depreciation accounts under "Maintenance of Way and Structures" for the purpose of creating a reserve to which (instead of Profit and Loss) should be charged the original cost, less salvage, of the property (other than land or equipment) abandoned, and all incidental expenses directly connected with the abandonment.

7. When the use of any land, the cost of which has been included in "Right of Way and Station Grounds" account or "Real Estate" account, is discontinued or abandoned, the original cost of the land (estimated, if not known) should be credited to the appropriate accounts under Additions and Betterments and charged, less salvage from sale or other disposal, if any, to Profit and Loss. If the land is retained by the carrier, the salvage should be charged at a fairly appraised value to an appropriate account to be included in the group of accounts described under "Other Permanent Investments" in the Form of General Balance Sheet Statement.

8. When buildings, structures, or facilities of one class are converted to another class, the original cost (estimated, if not known) of such buildings, structures, or facilities should be credited to the appropriate accounts under Additions and Betterments, and the value in the capacity to which converted should be charged to the account under which the property is now classified. The difference between the original cost, plus the cost of alteration or reconstruction, if any is incurred, less salvage, and the present value of such buildings, structures, or facilities should be charged to Operating Expenses.

9. No charge should be made against Additions and Betterments for services of regularly salaried operating officials and employees unless specifically assigned to additions and betterments work. When employees of the engineering department are assigned to additions and betterments work, their salaries and expenses, rent, and all other necessary expenses connected with that work should be charged to the special work on which they are engaged. In the redistribution of the expenditures covered by this Classification of Expenditures for Additions and Betterments in accordance with the Classification of Expenditures for Road and Equipment, engineering expenses should be charged to account No. 1, "Engineering," and not to the accounts representing the specific work under construction or improvement.

10. All expenditures incident to and directly connected with additions and betterments work, such as injuries to persons or damage to property, should be charged to the account covering the particular work in connection with which the expenses are incurred.

11. This classification applies exclusively to additions to, or betterments of, existing main and branch lines and their appurtenances and equipment.





## TEXT OF CLASSIFICATION OF EXPENDITURES FOR ADDITIONS AND BETTERMENTS.

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### 1. RIGHT OF WAY AND STATION GROUNDS.

To this account should be charged the cost of additional land (of necessary width conformable to depth and slope of excavations and embankments, including borrow pits and waste banks adjoining right of way) acquired for roadbed for additional main tracks; for new roadbed on account of changes of line; for new passing tracks, sidings, and spur tracks, or the extension of existing ones; for new station, terminal, and shop grounds or the enlargement of existing ones, including additional land purchased for ingress to or egress from such grounds; payments for right of way and station grounds on constructed lines, the title to which lands had not been acquired and payment for which had not been made before the construction accounts were closed; salaries and expenses of counsel, right-of-way agents, engineers, and assistants, when specially assigned to such matters; cost of stakes used to denote right-of-way limits; expenses of appraisals or of juries, commissioners, or arbitrators in condemnation cases; cost of removal of buildings from additional right of way or station or terminal grounds purchased; commissions paid to outside parties for purchase of additional right of way and grounds for the purposes above described; cost of plats, abstracts, notarial fees, recording deeds, etc. Payments for damages to abutting property caused by the construction of additional tracks, etc., as above described, should also be charged to this account. (See account No. 17, "Track Elevation, Elimination of Grade Crossings, etc.")

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—Proceeds from the sale of improvements included in a purchase, the total cost of which has been charged to

account No. 1, "Right of Way and Station Grounds," should be credited to the same account.

NOTE B. The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

## 2. REAL ESTATE.

To this account should be charged the cost of additional land acquired for use directly in connection with the operation of the road, but in excess of and in addition to that actually required for roadbed, or station, shop, or terminal grounds, including all expenses incident to the acquisition of such real estate. These are more fully enumerated in account No. 1, "Right of Way and Station Grounds."

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A. In the case of additional property acquired in connection with the purchase of right of way and station grounds, the amount to be charged to this account should be the actual value or an estimate of the salable value of the property in excess of that used for purposes enumerated under account No. 1, "Right of Way and Station Grounds."

NOTE B. When property charged to "Real Estate" account, not being required at time of purchase for roadbed, or station, shop, or terminal grounds, becomes a part of a carrier's right of way or station grounds through changes of line, or construction of additional main tracks, yards, etc., the amount originally charged should be credited to this account and charged to account No. 1, "Right of Way and Station Grounds," so that the account "Real Estate" may always represent the cost of land acquired for use directly in connection with the operation of the road, but in excess of and in addition to that actually required for roadbed, or station, shop, or terminal grounds.

NOTE C. Proceeds from the sale of improvements included in a purchase, the total cost of which has been charged to "Real Estate" account, should be credited to the same account.

NOTE D. This account does not apply to real estate the title to which is not held in the name of the railway company.

NOTE E. The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

## 3. WIDENING CUTS AND FILLS.

To this account should be charged the cost of additional grading done, whether excavations or embankments; clearing and grubbing; cost of material taken from borrow pits, and

haul, if allowed; amounts paid for the privilege of making waste banks outside company's right of way or station grounds because of widening cuts or of snow sloping cuts; also cost of reconstruction of turnpikes and roads when made necessary by this work. This account also includes the cost of excavation necessary to convert a tunnel into an open cut, as described in account No. 6, "Tunnel Improvements," and of filling bridges and trestles, as described in account No. 7, "Bridges, Trestles, and Culverts." It does not include the cost of any grading done in connection with, or as a portion of, grade revisions and changes of line.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of restoring banks to the original width, slope, or grade should be charged to the appropriate operating expense accounts, whether the work is done separately or incidentally to a general plan of increasing the standard width and slope of embankments. The cost of the work done in the execution of such a general plan should be divided between Operating Expenses and Additions and Betterments on the basis of the percentage that the number of yards of material required to restore the banks to the original standard bears to the total number of yards moved in the work. There should also be charged to Operating Expenses the cost of dressing the slopes of cuts and fills, reditching cuts, replacement of berm ditches, and necessary repairs to track, ballast, etc., after the completion of the improvement.

#### 4. PROTECTION OF BANKS.

To this account should be charged the cost of additional retaining walls and other masonry, piling, or riprap for the protection of embankments, cuts, or slopes; additional cribbing or bulkheading; dikes or levees built to protect the tracks or embankments along the seashore or banks of lakes and streams, including the cost of any additional cribs, breakwaters, wing dams and rock filling for same, or other devices constructed to change the direction of the current of a stream to prevent the washing of the bank.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of riprap at culvert ends or around bridge abutments or piers, to prevent washing or scouring, is chargeable to account No. 7, "Bridges, Trestles, and Culverts," when not properly an operating expense.

## 5. GRADE REVISIONS AND CHANGES OF LINE.

To this account should be charged.

**GRADE REVISIONS.**—(Reduction of grades by cutting down summits and raising sags without materially changing the alignment.) The amount to be charged to this account is the cost of additional grading done, including as a portion of such cost the rent and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools, etc., used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, and streets, including crossing gates, highway crossing alarms, and watch-houses.

**CHANGES OF ALIGNMENT.**—(Alteration of alignment for the purpose of reducing curvature, cutting out bridges, tunnels, etc.) The amount to be charged to this account is the excess cost of the grading and bridging done over the cost of replacing in kind the grade, bridges, tunnels, etc., on the portion of the old line that is abandoned.

**CHANGES OF LINE.**—(Construction of new lines for the purpose of improving grade or alignment.) The amount to be charged to this account is the difference between the cost of the new line and the cost of replacing in kind the line abandoned, exclusive of right of way. It includes the cost of engineering, clearing and grubbing, grading, tunnels, bridges, trestles and culverts, ties, rails, frogs, switches, track fastenings, and other track material; ballasting, track-laying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools, rent and expenses of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.**—The cost of such grading as is necessary to restore banks or cuts to original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting the traffic while passing over the tracks; rebalasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection, and moving and relocating telegraph or telephone poles,

signals, fences, buildings, etc., should all be charged to the appropriate operating expense accounts.

**NOTE B.**—The cost of buildings, water and fuel stations, and similar structures on new lines should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate accounts herein provided relating to the different classes of buildings and structures.

## 6. TUNNEL IMPROVEMENTS.

To this account should be charged the cost of enlarging tunnels (except when the enlargement is made necessary by the construction of additional main tracks), including the excess cost of lining the enlarged tunnel over the cost of replacing in kind the lining of the original tunnel; also the excess cost of permanently lining tunnels with stone, brick, or concrete, over the cost of renewing the temporary lining.

*See General Instructions preceding the list of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—In the event a tunnel is converted into an open cut, the cost of clearing, grubbing, and excavating (including the disposition of the excavated material), should be charged to account No. 3, "Widening Cuts and Fills." The cost of removing the lining of the tunnel, of protecting tracks and trains while the lining is being removed, and of restoring the tracks to proper condition for operation after the lining has been removed, should be charged to the appropriate operating expense accounts.

## 7. BRIDGES, TRETTLES, AND CULVERTS.

To this account should be charged the excess cost of new bridges, trestles, and culverts, both substructure and superstructure, erected to carry tracks over streams, ravines, streets, or other railways, over the cost of replacing in kind the existing structures. The cost of a bridge or trestle includes abutments, piers, supports, draw and pier protection; machinery to operate drawbridges; guard rails; cost of inspection of bridge material either at shop or at site of structure; cost of tests; masonry or concrete wing walls to abutments, and masonry or concrete ends and wing walls for culverts; cost of riprap at culvert ends or around bridge abutments and piers to prevent washing or scouring; cost of wing dams, cribs, or ice breakers for the purpose of regulating the current of a stream or breaking up ice jams; also labor and material used in painting structures.

When existing piers have to be strengthened or additional piers built in order to carry new bridges of a heavier type, the cost should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.**—The cost of removing old material and protecting traffic during improvements should be charged to Operating Expenses.

**NOTE B.**—When the erection of a new structure requires the use of "false work," which would not be required in replacing an existing structure, and such false work is furnished by the railway company, its cost should be charged to this account. Upon removal of the false work, the value of the material recovered should be credited to this account and charged to the account benefited, the cost of recovery being charged to this account.

**NOTE C.**—When a bridge or trestle is partly filled, a smaller waterway being provided, the cost (estimated, if not known) of that part of the bridge or trestle removed or filled should be credited to this account and such cost, less salvage, charged to the appropriate operating expense account, to which should be charged also the cost of removing the old material. The cost of constructing the new waterway should be charged to this account, and the cost of filling the remaining portion of the bridge or trestle should be charged to account No. 3, "Widening Cuts and Fills."

When a bridge, trestle, or culvert is completely filled, no waterway being provided, the cost of replacing in kind the existing structure should be credited to this account and charged to the appropriate operating expense account, which should receive credit for the value of the salvage recovered, and be charged with the cost of its recovery. The cost of filling should be charged to account No. 3, "Widening Cuts and Fills."

The cost of constructing bridges, trestles, or culverts where none previously existed, made necessary from the stopping up of natural waterways by the construction of embankments, should be charged to this account; the cost of replacing in kind that part of the embankment removed being credited to account No. 3, "Widening Cuts and Fills," and charged to the appropriate operating expense account, which should also be charged with the cost of removing the embankment.

**NOTE D.**—When bridges, trestles, and culverts are built in connection with or as a part of grade revisions and changes of line, additional main tracks, sidings and spur tracks, terminal yards, track elevation, elimination of grade crossings, etc., and reconstruction of road purchased, the cost of such structures should not be charged to this account, but should follow the cost of the work of which they form a part.

## 8. INCREASED WEIGHT OF RAIL.

To this account should be charged the excess cost of rails laid over the cost of rails of the same weight as the original pattern of the rails released, the cost to be based upon the price per ton (including freight and inspection) of the rails laid.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of distributing, laying, spiking, and jointing rails, surfacing and lining track, and picking up and removing old rails should not be charged to this account, but to Operating Expenses.

## 9. IMPROVED FROGS AND SWITCHES.

To this account should be charged the excess cost of heavier or improved frogs and switches over the cost of replacing the frogs and switches removed, the charge to be based upon the excess weight of the frogs and switches put in over the weight of those released, at the price of the frogs and switches put in if bought by weight. If the frogs and switches are of an improved (or patented) type, the excess cost of such frogs and switches over the cost of replacing those removed with others of the same pattern should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.** The cost of distributing new frogs and switches and picking up and loading frogs and switches removed in the course of betterment work should not be charged to this account, but to Operating Expenses.

## 10. TRACK FASTENINGS AND OTHER MATERIAL.

To this account should be charged the excess cost of heavier or improved types of track fastenings and other track material, such as fish and tie plates, splice or angle bars, continuous rail joints, chairs, rail braces, bolts, nuts, and nut locks or washers used in connection therewith, over the cost of replacing the material removed; the charge to be based upon the difference in weight between the material put in and that released, at the price paid for the material put in; except that when track fastenings or other track material of

an improved (or patented) type are put in track at a cost in excess of that paid for material of ordinary type, the excess cost of the improvement should also be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE. The cost of distributing and applying new track fastenings and other track material and picking up and loading material removed in the course of betterment work should not be charged to this account, but to Operating Expenses.

## 11. BALLAST.

To this account should be charged the cost of ballasting tracks not previously ballasted; also the cost of completing the ballasting of tracks not originally completely ballasted. It includes the cost of ballast, whether of broken stone, slag, gravel, or other material especially provided for this purpose; also the expense of loading (except as provided in Note A under account 2, "Ballast," in the Classification of Operating Expenses, Third Revised Issue), hauling, and unloading alongside track, including the rent and expenses of locomotives and cars, and pay of crews engaged in hauling and distributing; cost of spreading ballast and putting it under track; and cost of shovels, picks, track jacks, crowbars, levers, etc., used in this work.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—For instructions as to accounting for operations of gravel pits and quarries, see account No. 2, "Ballast," under "Maintenance of Way and Structures" in the Classification of Operating Expenses.

NOTE B.—The cost of keeping tracks passable for traffic while being ballasted, of patching or reinforcing ballast previously put under track, and of reballasting, should be charged to the appropriate operating expense accounts.

## 12. ADDITIONAL MAIN TRACKS.

To this account should be charged the cost (excepting cost of right of way, which should be charged to account No. 1, "Right of Way and Station Grounds") of new second or other additional main tracks, whether built alongside existing main tracks or alongside new first main tracks, the cost of



which is charged to account No. 5, "Grade Revisions and Changes of Line." It includes the cost of engineering; clearing and grubbing; grading; tunnels (either new tunnels or enlargement of existing tunnels to accommodate additional track or tracks); bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and other track material; ballasting, tracklaying, and surfacing; interlocking and signal apparatus; also cost of tools, rent and expenses of locomotives and cars, and pay of crews employed on the work.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—If, in constructing additional main tracks, it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct farm, country road, or street crossings, including crossing gates, highway crossing alarms, and watchhouses, the cost of such work should be charged to the appropriate operating expense accounts.

NOTE B.—When a change of line is undertaken and more main tracks are laid on the new line than there were on the abandoned line, such portion of the cost of building the new line as represents the additional cost caused by providing the additional main tracks should be charged to this account and not to account No. 5, "Grade Revisions and Changes of Line." (See text for that account.)

### 13. SIDINGS AND SPUR TRACKS.

EXPLANATORY NOTE.—Expenditures made for the construction of Branch Lines are to be charged in accordance with the Classification of Expenditures for Road and Equipment. Branch Lines are defined as: Lines serving one or more stations beyond the point of junction with main line or another branch line, and to or from which stations regular tariff rates are in effect. Spur tracks are defined as: Lines constructed to reach or serve industries, such as mills, mines, smelters, factories, etc., over which regular scheduled passenger or freight train service is not performed, and for transportation over which only a switching charge, if any, is made.

To this account should be charged the cost (except cost of right of way, which should be charged to account No. 1, "Right of Way and Station Grounds") of additional spur tracks, including such spur tracks as are described in the preceding explanatory note, passing tracks, side tracks, and additional tracks in yards other than yards at division or

train terminal points, and the cost of extending existing tracks of the kind mentioned. This account includes engineering expenses; clearing and grubbing; grading; cost of bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and other track material; ballasting, track-laying, and surfacing; additional interlocking and signal apparatus; also cost of tools, rent and expenses of locomotives and cars, and pay of crews employed in the work. It does not include cost of tracks in shop buildings or enginehouses, on transfer tables or turntables, tracks leading from transfer tables or turntables to shop buildings or enginehouses, or tracks on inclines to fuel stations.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—If, in the construction of additional or in the extension of existing passing tracks, side tracks, or spurs, it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct farm, country road, or street crossings at grade, including crossing gates, highway crossing alarms, and watchhouses, the cost of such work should be charged to the appropriate operating expense accounts.

NOTE B.—Old or second-hand rails removed from main tracks and relaid in spur tracks, sidings, etc., should be charged to this account at their depreciated value at the time of relaying.

NOTE C.—The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

#### 14. TERMINAL YARDS.

To this account should be charged the cost (except the cost of right of way, which should be charged to account No. 1, "Right of Way and Station Grounds") of additional yards, or of enlarging existing yards, at division and terminal points, including yards at such junctions as are the train terminals of branch lines. It includes yards outside large cities when such yards are the train terminals and when cars are handled between those yards and city or other yards by transfer or switching locomotives.

The expenditures chargeable to this account include engineering expenses; clearing, grubbing, and grading; cost of bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and other track material; ballasting, track-

laying, and surfacing; additional interlocking and signal apparatus; also cost of tools, rent and expenses of locomotives, steam shovels and cars, and pay of crews employed in the work.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.**—When it is necessary to rearrange or relocate existing tracks in order to enlarge a terminal yard, the cost of such work should be charged to the appropriate operating expense accounts, the charge to this account being limited to the cost of additional linear feet of track and number of switches in the yard, as rearranged and enlarged, over the linear feet of track and number of switches originally in the yard.

**NOTE B.**—If, in the construction of additional or the enlargement of existing terminal yards it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct farm, country road, or street crossings at grade, including crossing gates, highway crossing alarms, and watchhouses, the cost of such work should be charged to the appropriate operating expense accounts.

**NOTE C.**—The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

## 15. FENCING RIGHT OF WAY.

To this account should be charged the cost of board, wire, rail, hedge, stone, or other fences along the right of way or limits of roadbed not previously fenced, including crossing gates, cattle guards, and wing fences thereto.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.** No charge should be made to this account for fences constructed on change of line (see account No. 5, "Grade Revisions and Changes of Line") around stock yards, fuel stations, station grounds, and shops, or on other properties outside right of way, the cost of such fences being chargeable to the appropriate accounts. The cost of additional permanent or portable fences for protection of tracks from snow or sand should not be charged to this account, but to account No. 30, "Snow and Sand Fences and Snowsheds."

**NOTE B.**—The \$200 minimum mentioned in the General Instructions preceding this classification does not apply to this account.

## 16. IMPROVEMENT OF OVER AND UNDER GRADE CROSSINGS.

To this account should be charged the cost of improvements made to existing overhead bridges and subways carrying roads, highways, or streets over or under tracks. This includes excess cost of improved overhead bridges over cost of replacing in kind existing bridges; cost of extension of overhead bridges made necessary by construction of additional main tracks, sidings, spur tracks, and terminal yards, or the extension of existing ones, including excess cost of grading new approaches to such bridges over the cost of grading the approaches abandoned or removed; cost of improvements to the roadway of existing overhead bridges and subways, including the roadway on the approaches thereto. When the extension of an existing overhead bridge calls for the alteration or modification of the existing structure, the amount chargeable to this account is only the excess cost of the new structure complete over the cost of replacing in kind the existing structure.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—The cost of taking down abutments, piers, posts, etc., of overhead bridges and rebuilding them in new locations should be charged to the appropriate operating expense accounts.

NOTE B.—The cost of improvement of bridges and trestles carrying tracks over streets should not be charged to this account, but to account No. 7, "Bridges, Trestles, and Culverts," and the cost of substituting overhead bridges or subways under tracks for existing grade crossings should be charged to account No. 17, "Track Elevation, Elimination of Grade Crossings, etc."

NOTE C.—When subways or undergrade crossings are built in connection with grade revisions or changes in line, or the extension of existing main tracks, sidings and spur tracks, or terminal yards, or the construction of additional ones, the cost of the subways and of the bridges carrying the tracks over them should be charged to the appropriate account as a portion of the cost of such tracks or work, in the same manner as the cost of any other bridges in the line, and not to this account.

## 17. TRACK ELEVATION, ELIMINATION OF GRADE CROSSINGS, ETC.

To this account should be charged the cost of eliminating grade crossings (including payments for damages to adjacent

property and expenses of litigation incident thereto) by eliminating farm crossings, country roads or highways, streets, or tracks of other railway companies, either under or over the tracks of a railway, whether the crossings are eliminated singly or in groups of two or more, or whether several consecutive crossings are eliminated by elevating or depressing the railway tracks for a considerable distance.

When single crossings are abolished, or when several highways or streets are brought together and carried under or over railway tracks, the charges to this account should include the cost of any land purchased for the relocation of the highways or streets; cost of labor and material used in grading, sewerage, paving, curbing, and building sidewalks on new streets; grading the street approaches to overhead bridges or to subways, and sewerage, paving, curbing, and building sidewalks on such approaches, if required; retaining walls, riprap, or other bank protection to the highway, abutting property, or roadbed; overhead bridges, including abutments, piers, posts, paving, sidewalks, railings, painting, carrying water and gas mains thereon, and lighting; telltales or whip signals at overhead bridges; excavation for subways; bridges carrying tracks over subways, including abutments with wing walls, piers, and posts; raising or lowering railway tracks in order to reduce excavation for subways or to give proper clearance at overhead bridges without making too steep a grade on approaches; and all other expenditures incident to completing overgrade and undergrade crossings. The structures above described do not include subways and overhead foot bridges (not public highways) at stations.

When a grade crossing over the tracks of two or more railway companies is eliminated, the charges to this account should include also such amounts as may be paid for work on another company's tracks in accordance with any contract or conditions governing the elimination of the grade crossing.

When several consecutive grade crossings are eliminated by elevating or depressing railway tracks for a considerable distance, the charges to this account should include the cost of steel or other elevated structure carrying tracks; masonry or concrete retaining walls; cost of bridges carrying tracks over streets, including cost of abutments, earth filling, piers, posts, and painting; lowering the grade of streets crossing under tracks and approaches thereto, including such repairs to sewerage, paving, curbing, and sidewalks as may be neces-

sary; excavation for depressing tracks and retaining walls, including fences thereon; abutments, piers, and posts for overhead bridges; cost of such bridges, including painting, paving, and lighting thereof; grading street approaches to overhead bridges, including such repairs to sewerage, paving, curbing, and sidewalks as may be required; cost of elevating or depressing depots, other buildings, and platforms, their approaches and exits; and other expenses incident to the completion of a continuous elevated or depressed track with subways or overhead bridges carrying streets under or over it.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.** The cost of all repairs to tracks, raising or lowering them as filling or excavation progresses; keeping them in condition to handle traffic, and protecting traffic thereon; but lasting on completion of work of previously ballasted; repairs to interlocking, block, and other signal systems, including the elevation or depression thereof during the progress of work, and other similar expenses, should be charged to the appropriate operating expense accounts.

**NOTE B.** The cost of subways carrying streets under tracks, built or extended in connection with grade revisions or changes of line, additional main tracks, sidings, spur tracks, and terminal yards should not be charged to this account, but to the appropriate account, as the cost of bridges carrying tracks over streets becomes a portion of the cost of tracks, the same as if over a stream or ravine.

**NOTE C.** Amounts collected from States or municipalities or from other railway companies as their contributions to, or proportion of, the cost of eliminating grade crossings, should be credited to this account.

## 18. INTERLOCKING APPARATUS.

To this account should be charged the cost of additional interlocking apparatus. This includes the cost of labor and material, levers, racks, wires, pulleys, semaphore, semaphore signals, ground signals, posts, material in box troughs, and other fixtures; towers and foundations for them; power plants, if any; batteries and wire; and all work necessary to complete the interlocker.

To this account should also be charged the excess cost of larger or improved interlocking plants over the cost of replacing in kind existing plants; also the cost of enlarging interlockers for the purpose of handling additional switches, but in such cases the amount chargeable to this account is

only the difference between what it would cost to install a new plant complete, according to the revised plan, and the cost of replacing in kind the existing plant.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of changing connections or locations of semaphores and other signals in the course of betterment work should be charged to Operating Expenses.

## 19. BLOCK AND OTHER SIGNAL APPARATUS.

To this account should be charged the cost of additional apparatus for all classes of block and other signals. It includes the cost of labor and material, levers, racks, wires, pulleys, semaphores, semaphore signals, ground signals, posts, material in box troughs, and other fixtures; towers, operators' offices or houses, and foundations for them; signal bells, including crossing alarm bells; power plants, if any; batteries and wires, bonding rails, and other appliances incident thereto; and all other work necessary to complete the additional signal systems.

To this account should also be charged the excess cost of improved systems of block and other signal apparatus over the cost of replacing in kind existing signal apparatus.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of altering or changing any system of block or other signals to connect two or more signal systems so that they may be operated as one system, and the cost of changing connections or locations during betterment work, should be charged to the appropriate operating expense accounts.

## 20. TELEGRAPH AND TELEPHONE LINES.

To this account should be charged the cost of additional telegraph and telephone lines, including conduits, poles, cables, wires, billers, insulators, tie wires, instruments, and all other materials used; also cost of labor employed and all tools used in this work. To it should also be charged the cost of stringing additional telegraph and telephone wires on existing pole lines.

When an improved wire is substituted for an inferior wire, the excess cost of the improvement over the cost of replacing in kind the wire removed should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

## 21. STATION BUILDINGS AND FIXTURES.

To this account should be charged the cost of additional station buildings or structures of every character, and the cost of additional fixtures, furniture, and facilities necessary to equip such new buildings for service or to enlarge the equipment of existing station buildings and structures; also the excess cost of new buildings or new furniture, fixtures, and facilities over the cost of replacing in kind buildings, furniture, fixtures, and facilities removed. The following items are chargeable to this account: Architect's fees, beautifying grounds, drainage systems, electric fixtures and wiring, elevators, excavations, fences, gas fixtures, foot bridges and highways, furniture, grading, heating apparatus, hedges, king stations, paving, platforms, piping, pumps, sidewalks, stationary scales, station signs, stock pens, stoves, subway turnstiles, water fixtures, and wells.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.** This account should not include the cost of additional station buildings on docks, wharves, or piers, or the excess cost of improving existing ones, but such cost should be charged to account No. 26, "Dock and Wharf Property."

**NOTE B.** The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

## 22. SHOPS, ENGINEHOUSES, AND TURNABLES.

To this account should be charged the cost of additional shops, enginehouses, and turnables, and of additional fixtures, facilities, and appurtenances (other than shop machinery and tools) necessary to equip new shops, enginehouses, and turnables; the cost of enlarging the plant and equipment of existing shops, enginehouses, and turnables; also the excess cost of new buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind



buildings or structures, and fixtures, facilities, and appurtenances removed.

This account should include the cost of the following buildings or structures when built as parts of or in connection with shops, enginehouses, and turntables: Car sheds, cinder pits, drop pits, electric light and power plants, outhouses, sand houses, scrap bins, storehouses, tracks, and transfer tables. To it should also be charged the cost of the following items incidental to the construction or improvement of the buildings or structures mentioned: Architect's fees, beautifying grounds, excavations, foundations, electric fixtures, fences, gas fixtures, grading, heating plants and apparatus, hedges, platforms, sewerage systems, sidewalks, turntable levers, tractors, and stops; water system connections.

*See General Instructions preceding the list of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE.**—The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

## 23. SHOP MACHINERY AND TOOLS.

To this account should be charged the cost of additional machinery and tools placed in shops or enginehouses and not replacing other tools and machinery, including foundations therefor, cost of transportation, loading, unloading, and placing machinery in position. This account includes the cost of additional stationary engines and boilers, automatic stokers, ash conveyors, electric generators and motors, switchboards, compressors, shafting, belting, cranes, stationary and portable forges, trip hammers, lifting magnets, and hydraulic, pneumatic, and electric machines, together with all other additional machinery and tools placed in shops and enginehouses, including the necessary small hand tools first to equip a new and additional shop, but not including additional small hand tools furnished to shops or enginehouses already in operation.

To it should also be charged the excess cost of machinery and tools of an improved type or character installed in shops or enginehouses in substitution for machinery and tools of obsolete or inferior type or character over the cost of replacing in kind existing machinery or tools. The excess cost of foundations for new machinery over the cost of replacing in kind the foundations for existing machinery and the cost of unloading and placing the machinery thereon, should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

#### 24. WATER AND FUEL STATIONS.

To this account should be charged the cost of additional structures and the cost of enlarging existing structures used as, or in connection with, stations for supplying locomotives with water or fuel; also the excess cost of new structures of this class over the cost of replacing in kind structures removed. The following items are chargeable to this account:

For water stations: Boilers, cisterns, dams, engines, and fixtures; fences, foundations, penstocks and connections, pipe lines and piping, pumps, pumphouses, purifying plants, settling basins, stand pipes, tanks, tubs, track tanks or troughs, wells, windmills, and other machinery and appliances necessary to operate water stations.

For fuel stations: Ash handling plants, buckets, cranes, chutes, dumping machinery, elevators, engines (stationary), fences, platforms, scales, sheds, tipple cars, wood racks, fuel oil plants, inclines at fuel stations and tracks on same, and other machinery and appliances necessary to operate fuel stations.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE A.—This account should not include waterworks, wells, fuel stations, coal houses, etc., used exclusively for supply of shops, power plants, stations, hotels, tenement or section houses, which should be charged to the appropriate accounts.

NOTE B.—The cost of restoring condition of grounds after betterment work, including the filling of abandoned wells and cisterns, should be charged to Operating Expenses.

#### 25. GRAIN ELEVATORS AND STORAGE WAREHOUSES.

To this account should be charged the cost of additional grain elevators and storage warehouses, including the cost of foundations, conveyors, machinery and fixtures therein, and all other charges incident to construction. To it should also be charged the cost of additional conveyors, machinery, and fixtures for such buildings, with foundations, if any; also the excess cost of improved machinery, fixtures, etc., over the cost of replacing in kind existing machinery, fixtures, etc. When the buildings are altered or enlarged, the portion of

the cost of the improvement to be charged to this account is the difference between what it would cost to build the structure according to the revised plan and the cost of replacing in kind the existing structure.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

**NOTE A.**—The cost of filling foundations and restoring condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

**NOTE B.** The buildings referred to in this account are not small storage elevators at way stations or ordinary freight warehouses where freight is received for shipment, etc., but large elevators, in which a regular grain business is handled or grain is stored for various owners, and warehouses in which merchandise is stored. Small storage elevators at way stations are classed as station buildings.

## 26. DOCK AND WHARF PROPERTY.

To this account should be charged the cost of additional docks, wharves, ferry and other landings, and inclines to transfer steamers, including buildings, structures, coal and ore handling machinery, and other appurtenances thereon; dredging of slips; piling; filling cribs; pile protection; building cofferdams; pumping or balling water; masonry walls or filling, etc., and all other expenditures incident to construction, except the cost of tracks.

To this account should also be charged the cost of improving existing docks, wharves, ferry or other landings, and inclines to transfer steamers, by—

(a) Erecting thereon additional buildings or structures and placing thereon additional coal and ore handling machinery and other appurtenances; dredging new slips, extending docks or wharves, and generally improving or bettering the plant, without altering or modifying the existing one;

(b) Rebuilding the docks, wharves, landings, inclines, or buildings and structures thereon in an improved or more substantial manner; substituting modern, more powerful, or improved machinery for existing machinery; filling pile docks or wharves, substituting masonry or concrete walls or ends for piling, etc.; but in the case of improvements of this class, the amount to be charged to this account is the excess cost of rebuilding the dock, wharf, landing, incline, building, or structure, or of substituting the machinery and appurtenances, over

the cost of replacing in kind the existing dock, wharf, landing, incline, building, structure, machinery, or appurtenances.

*See General Instructions preceding the text of this classification covering method of handling accounts relative to property abandoned or converted to other uses, and to unaccruing expenses.*

NOTE A.—The cost of restoring the condition of the dock, or wharf and land upon which it is situated after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

NOTE B.—The cost of ground on which additional docks or wharves are built and of riparian or water rights in connection therewith should be charged to account No. 1, "Right of Way and Station Grounds."

## 27. ELECTRIC LIGHT AND POWER PLANTS.

To this account should be charged the cost of additional electric lighting plants (when not used exclusively in connection with station buildings, shop plants, or office buildings, and so covered by accounts Nos. 21, 22, and 31, "Station Buildings and Fixtures," "Shops, Enginehouses, and Turntables," and "Miscellaneous structures"), including the cost of buildings specially erected for electric light plants, dynamos, or generators; boilers and engines for running dynamos and generators; storage batteries, poles, insulators, and wires constituting electric light lines; glass globes; carbon or arc lamps; carbonized filament for incandescent lamps; hangers for lights; and other expenses incident to the erection of new and additional plants; also the cost of additional stations (whether operated by steam or water power, but not including plants used exclusively for furnishing power at shops and so covered by account No. 22, "Shops, Enginehouses, and Turntables"), where power is generated for the operation of trains and cars, including cost of power houses and car sheds at power plants; flowage rights, dams and reservoirs, penstocks, water wheels or turbines; engines, boilers, pumps, condensers, generators, transformers, and other machinery, including foundations therefor and setting machinery thereon; switchboards and lighting apparatus, and all expenses incident to the erection of new and additional power plants for the purposes named.

To this account should also be charged the cost of improvements or betterments of existing electric light and power plants of the character above described, whether by installation of additional machinery, enlargement of plant, substitution of more powerful and modern machinery, or otherwise.

When the improvement is a distinct addition to the plant and does not call for any alteration, the entire cost thereof should be charged to this account. When the improvement calls for a modification or alteration of an existing structure or facility, there should be charged to this account only the excess cost of constructing the structure or facility on the revised plan over the cost of replacing in kind the original structure or facility, and when the improvement calls for the substitution of improved machinery, etc., only the excess cost of such machinery over the cost of replacing in kind that existing should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE: The cost of restoring the condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

## 28. ELECTRIC-POWER TRANSMISSION.

To this account should be charged the cost of additional systems for the transmission of electricity for power purposes, including span, guard, feed, and overhead trolley wires; poles, cross-arms, brackets, insulators, and connections; third rails, including braces, supports, and devices for insulating, covering, or protecting; bonding rails, including connecting plugs, insulating mats, plugs, or other devices; switchboards, switches, cut-outs, transformers, etc. (not at power stations or substations), and any other expenditures incurred in connection with the building of additional lines for transmission of electric power.

To this account should also be charged the cost of improvements or betterments of existing lines for the transmission of electric power, such as the substitution of the third rail for the overhead trolley system; substitution of iron for timber poles, or heavier for lighter wires; and other improved electric devices, etc. When the betterment or improvement is a distinct addition to the existing system and does not call for any modification or alteration of it, the entire cost thereof should be charged to this account. When the improvement calls for a change in plan or substitution of parts or machinery, there should be charged to this account only the excess cost of the new work or machinery over the cost of replacing in kind the existing parts or machinery.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

## 29. GAS-PRODUCING PLANTS.

To this account should be charged the cost of additional gas producing or compressing plants complete.

To this account should also be charged the cost of improvements or betterments of existing gas producing or compressing plants, whether by installation of additional machinery and appliances, by enlargement, or by the substitution of modern and more powerful machinery and appliances, etc. When the improvement or betterment is a distinct addition to the plant, and does not call for any alteration, the entire cost of the work should be charged to this account. When the improvement calls for the enlargement, modification, or alteration of the existing structure, there should be charged to this account only the excess cost of the structure on the revised plan over the cost of replacing in kind the existing structure; and when the improvement calls for the substitution of improved machinery, etc., only the excess cost of such machinery, etc., over the cost of replacing in kind that existing, should be charged to this account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE.—The cost of restoring the condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

## 30. SNOW AND SAND FENCES AND SNOWSHEDS

To this account should be charged the cost of additional snowsheds, including rock filling when necessary, and permanent or portable fences for protection of tracks from snow and sand.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

NOTE.—When permanent snow or sand fences take the place of existing right-of-way fences, the entire cost of the new fences should be charged to this account, the original cost (estimated, if not known) of the right-of-way fences

removed being credited to account No. 15, "Locating Right of Way," and charged, together with the cost of removal, less salvage, to the appropriate operating expense account.

### 31. MISCELLANEOUS STRUCTURES.

To this account should be charged the cost of additional structures of every character which are permanent and constitute an addition to the property, and which are not otherwise herein particularly referred to, including the cost of material, labor, and all incidental expenses connected therewith, the purpose being to designate one primary account to which may be charged the cost of all such additional structures, and so to avoid an increase in the number of primary accounts.

To this account should also be charged the cost of enlarging or otherwise improving any of the structures embraced in this account, the amount of such charge being the excess cost of constructing the building or structure according to the revised plan over the cost of replacing in kind the existing building or structure.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

### 32. RECONSTRUCTION OF ROAD PURCHASED.

To this account should be charged the cost to the purchasing company of reconstructing or substantially rebuilding a purchased road in order to bring it up to the desired standard. Such work would include engineering expenses; purchase of additional right of way and station grounds to provide for changes of line; building terminal yards, extending existing passing tracks, sidings, etc., and laying additional ones; widening cuts and fills; protecting banks; widening gauge; revising grades, improving alignment and changing line; improving tunnels; rebuilding or strengthening bridges, trestles, and culverts; relaying tracks; ballasting; building additional main tracks (as defined in account No. 12, "Additional Main Tracks") and passing tracks; extending existing passing tracks, sidings, and spurs; building additional terminal yards, or enlarging and rearranging existing ones; fencing right of way; eliminating grade crossings and improving existing overgrade and undergrade crossings; erecting interlocking plants, or block and other necessary signal apparatus; building new or rebuilding existing telegraph and

telephone lines; rebuilding station buildings, shops, engine-houses, and turntables, water and fuel stations, grain elevators and storage warehouses, dock and wharf property, electric light and power plants, electric power transmission lines, gas-producing plants, and miscellaneous structures; replacement of shop machinery and tools; rebuilding existing and constructing necessary additional snow and sand fences and snowsheds.

Charges to this account do not include the cost of rebuilding, reconstructing, or replacing the equipment purchased with the road. Such equipment, when purchased, should be inventoried and appraised and charged at the appraised value to account No. 33, "Equipment;" when the equipment is replaced or rebuilt, the expenditures should be charged in accordance with the rules laid down in that account.

*See General Instructions preceding the text of this classification covering method of handling accounts relating to property abandoned or converted to other uses, and to engineering expenses.*

### 33. EQUIPMENT.

To this account should be charged the cost of all newly acquired equipment and appurtenances thereto, as follows:

The cost of steam locomotives, electric locomotives, passenger-train cars, freight-train cars, work equipment, and floating equipment purchased, or built at company's shops, including all appurtenances and furniture and fixtures necessary to equip them for service; transportation over foreign lines, cost of inspection and of setting up and trying after receipt from builders.

The cost of improvements to equipment, such as applying electric headlights, power brakes, vestibules, motors for self propulsion, axle lighting apparatus, etc.; provided that, when the improvement is a distinct addition to the equipment, the entire cost thereof should be charged to this account; when the improvement is a betterment of existing parts or appurtenances, there should be charged to this account only the excess cost of the improved parts or appurtenances over the cost of replacing in kind the original.

When any equipment is converted into equipment of another class, this account should be credited or debited with the difference between the original cost (estimated, if not known) of the equipment and its appraised value after conversion. The Replacement Account should be debited with the amount of depreciation accrued on the equipment at time



of conversion, proper account being taken of any salvage; and to the repair account, under "Maintenance of Equipment," to which repairs on the equipment as converted would be assigned, should be carried the difference between (1) the sum of the original cost of the equipment and the cost of making the change; and (2) the sum of the appraised value of the converted equipment, the salvage, and the accrued depreciation charged to Replacement Account. Thereafter depreciation should be charged on the basis of the value of the equipment as converted. This paragraph does not apply when only minor changes are made in equipment, such as double-decking a stock car, or when, on account of its age or condition, a car is used for a different class of traffic than that for which originally intended, such as designating a box car to be used "for oil only," etc.

When work equipment is bought by a railway company for use in additions and betterments work, as for instance in a change of line, the cost of such equipment should be charged to the work upon which it is to be used, and, if sold after completion of the work, the proceeds should be credited to the same account. If after completion of the work the equipment is retained for use on general work, its appraised value should be charged to this account (Equipment) and credited to the account originally charged when the equipment was bought.

When any equipment is retired from service, the original cost (estimated, if not known) or present record value of such equipment should be credited to this account and charged to Replacement Account, the Replacement Account having been previously credited with the accrued depreciation, salvage, if any, and amount charged to Renewals as provided in the Classification of Operating Expenses.

No charge to Operating Expenses may be made for depreciation accrued before July 1, 1907. Accrued depreciation on equipment in service on that date, not otherwise written off, should be charged to Profit and Loss.

*NOTE.*—A classification of the different kinds of equipment may be found under the several equipment repair accounts in the Classification of Operating Expenses, Third Revised Issue.

### 34. INTEREST AND COMMISSIONS.

To this account should be charged bona fide commissions on securities sold, interest and commissions on loans effected, and on notes issued for money borrowed for the purpose of paying for work or equipment charged to Additions and

Betterments; interest on overdue payments to contractors or other creditors on account of such work; and bank discount (prepaid interest), interest, commissions, and exchange on other commercial paper utilized for similar purposes. Interest on bonds, notes, or other securities sold to provide funds to pay for additions, betterments, and additional equipment, that accrues before completion of the work or receipt of the equipment, is chargeable to this account. Interest receivable accrued on moneys or credits provided for this purpose should be credited to this account. Interest that accrues after the completion of the work or receipt of the equipment by the carrier is not chargeable to this account.

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**CLASSIFICATION**  
**OF**  
**EXPENDITURES FOR ADDITIONS**  
**AND BETTERMENTS**

**AS PRESCRIBED BY THE**  
**INTERSTATE COMMERCE COMMISSION**  
**FOR**  
**STEAM ROADS**

**IN ACCORDANCE WITH**  
**SECTION 20 OF THE ACT TO REGULATE**  
**COMMERCE**

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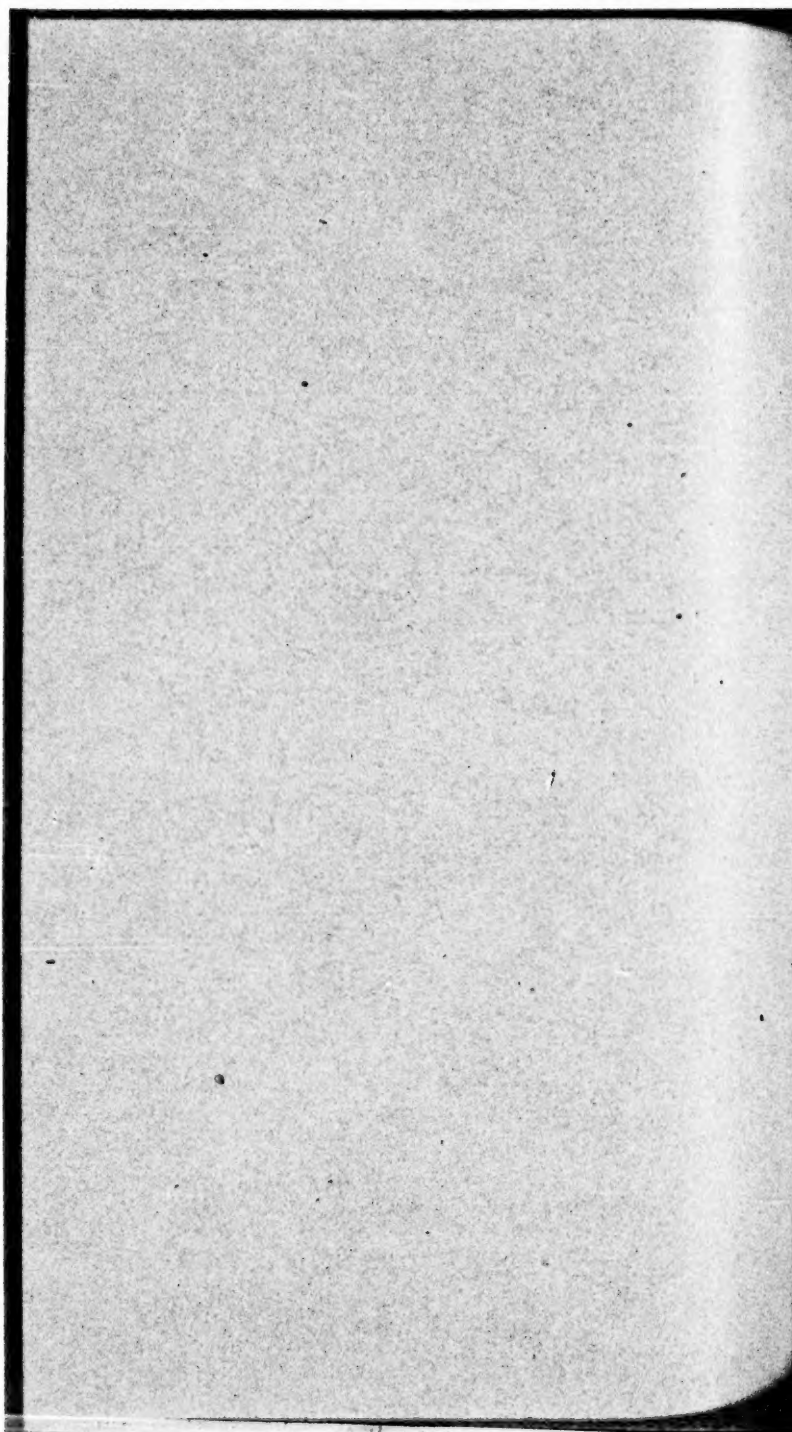
**FIRST REVISED ISSUE**

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*Effective on July 1, 1910*

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**WASHINGTON**  
**GOVERNMENT PRINTING OFFICE**  
**1910**



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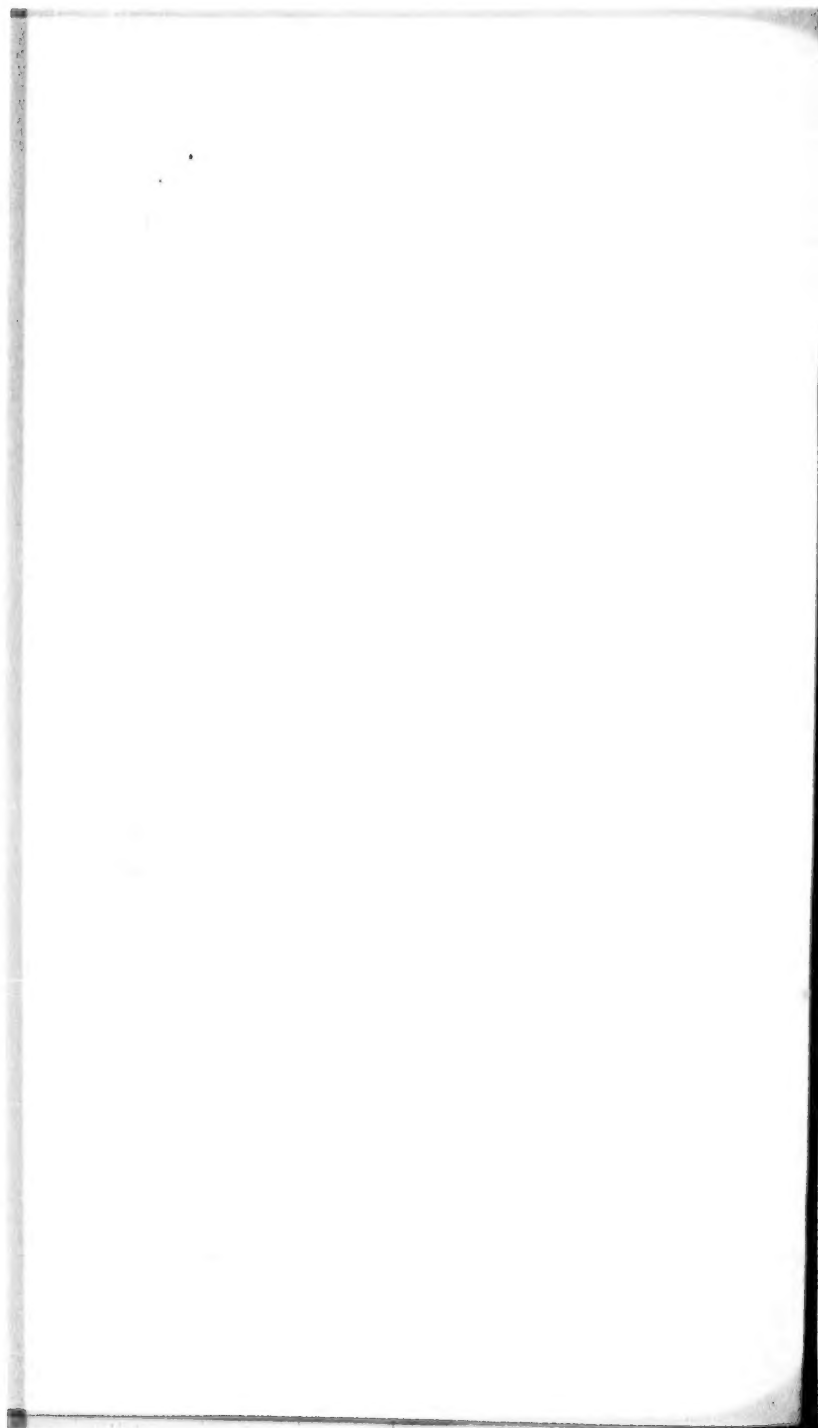
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## THE INTERSTATE COMMERCE COMMISSION.

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MARTIN A. KNAPP, *of New York.*

JEDSON C. CLEMENTS, *of Georgia.*

CHARLES A. PROUTY, *of Vermont.*

FRANCIS M. COCKRELL, *of Missouri.*

FRANKLIN K. LANE, *of California.*

EDGAR E. CLARK, *of Iowa.*

JAMES S. HARLAN, *of Illinois.*

EDWARD A. MOSELEY, *Secretary.*

(3)





At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D. C., on the 31st day of May, 1910.

*Present:*

MARTIN A. KNAPP,	Commissioners.
JUDSON C. CLEMENTS,	
CHARLES A. PROUTY,	
FRANCIS M. COCKRELL,	
FRANKLIN K. LANE,	
EDGAR E. CLARK,	
JAMES S. HARLAN,	

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

*It is ordered,* That the Classification of Expenditures for Additions and Betterments for Steam Roads, and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, as Chief of the Statistics and Accounts, and embodied in printed form, which hereafter known as First Revised Issue, as such as is now before this Commission, be, and the same be so approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, be filed in the office of the Bureau of Statistics and Accounts; and that each of said copies so authenticated and filed be deemed an original record thereof.

*It is further ordered,* That the said Classification of Expenditures for Additions and Betterments, First Issue,

vised Issue, with the text pertaining thereto be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of their accounts of expenditures for additions and betterments; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts of expenditures for additions and betterments in conformity therewith; and that a copy of the said First Revised Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

*It is further ordered,* That the rules contained in the said First Revised Issue of the Classification of Expenditures for Additions and Betterments are, and by virtue of this order do become, the lawful rules according to which the said expenditures for additions and betterments are defined; that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of the accounts of expenditures for additions and betterments of any such carrier; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier or for any person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier to keep any account or record or memorandum of any item of expenditure for additions or betterments except in the manner and form in the said First Revised Issue set forth and hereby prescribed, and except as hereinafter authorized.

*It is further ordered,* That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in the said First Revised

Issue established as may be required for the purposes of any such carrier or of any receiver or operating trustee of any such carrier; or may make assignment of the amount charged to any such primary account to divisions, to its individual lines, or to States: *Provided, however,* That a list of such subprimary accounts set up or such assignments made by any such carrier or by any receiver or operating trustee of any such carrier be first filed in the office of the Bureau of Statistics and Accounts of this Commission subject to disapproval by the Commission.

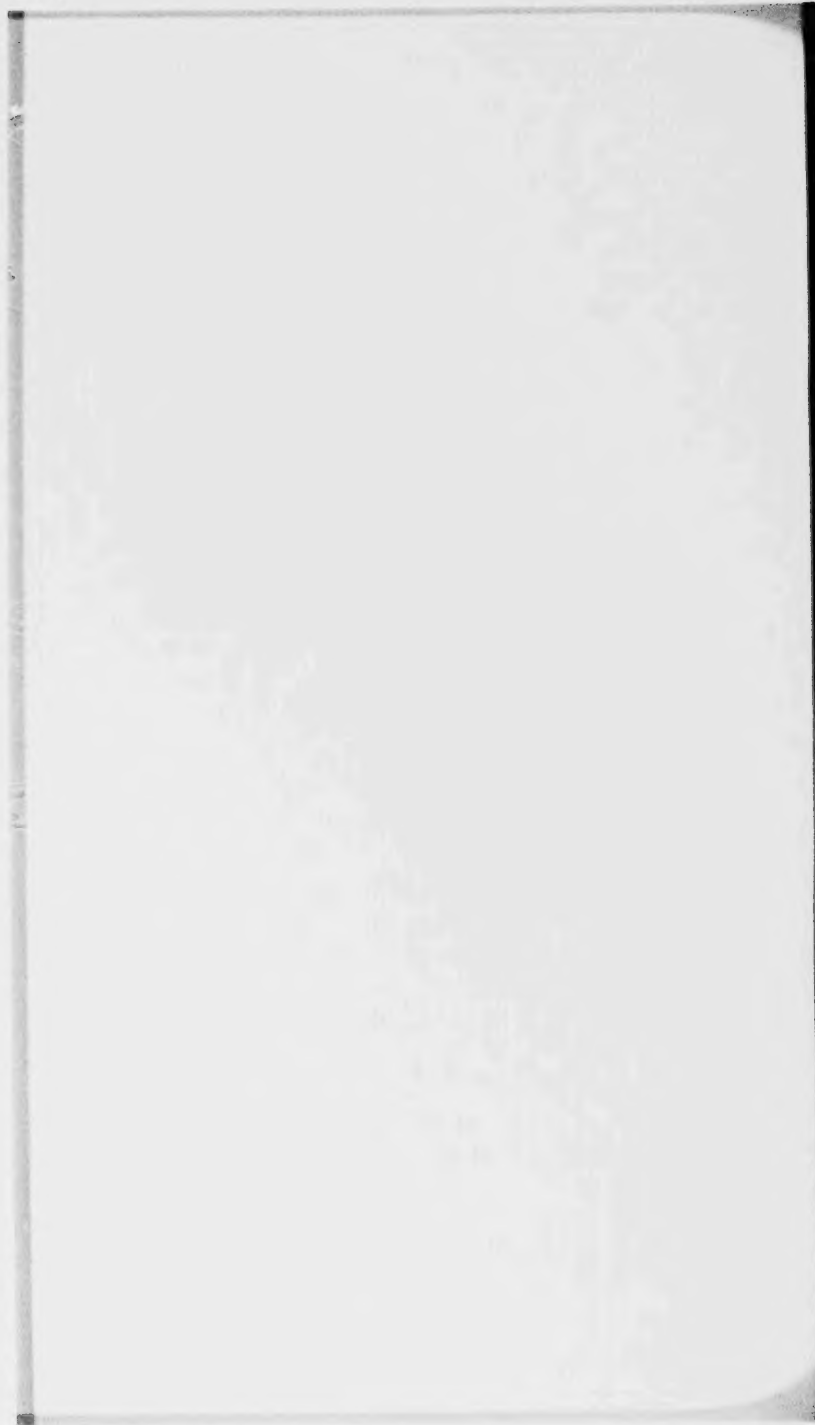
*It is further ordered,* That any such carrier or any receiver or operating trustee of any such carrier may, in addition to the accounts of expenditures for additions and betterments hereby prescribed, keep any temporary or experimental accounts the purpose of which is to develop economies in expenditures for additions and betterments: *Provided, however,* That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed; and that any such temporary or experimental accounts shall be open to inspection by the Commission.

*It is further ordered,* That July 1, 1910, be, and is hereby, fixed as the date on which the said First Revised Issue shall become effective.

A true copy:

EDW. A. MOSELEY,

*Secretary.*



## INTRODUCTORY LETTER.

INTERSTATE COMMERCE COMMISSION,  
BUREAU OF STATISTICS AND ACCOUNTS,  
*Washington, June 1, 1910.*

### TO CARRIERS CONCERNED:

The Classification of Expenditures for Additions and Betterments, First Issue, was promulgated under date of June 21, 1909.

A study of the questions arising from the application of that classification, and a consideration of the suggestions submitted by those responsible for its application, have led to the conclusion that it is desirable, at this time, to issue a revised edition and to grant carriers certain options which the previous classification did not grant.

A new account, A 22, "Roadway Machinery and Tools," is provided to include the cost of such roadway machinery and tools (other than small hand tools) as may, under the conditions therein imposed, properly be included in the property accounts. The title of the account "Miscellaneous Structures," as it appeared in the First Issue, has been changed to "Other Additions and Betterments," and the scope of the account has been somewhat enlarged. The General Instructions and the text of several accounts have been rewritten for the purpose of making clear certain points about which doubts have been expressed.

The text of the Equipment account now provides that when equipment is practically rebuilt the reserve for accrued depreciation shall be adjusted and the basis for depreciation on such equipment amended to meet the changed conditions. In making an estimate of a proper rate to be applied for depreciation on equipment, it will be necessary to consider only its probable life in service as prolonged by usual repairs.

HENRY C. ADAMS,  
*In charge of Statistics and Accounts.*



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## GENERAL INSTRUCTIONS.

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1. **APPLICATION OF THIS CLASSIFICATION.**—This classification should be so applied as to reflect the net increase or decrease (determined according to the rules provided) in the investment of a carrier in such property as is used in the operation of railways as transportation agencies, including outside operations incidental to furnishing transportation. Entries in the accounts prescribed in this classification should be made only with respect to additions to, betterments of, and withdrawals and retirements of property composing the plant and equipment of existing main and branch lines, including sidings and spur tracks and the necessary buildings, structures, and facilities. Until such time as a new railway or any important section of it, constructed as an extension of existing main or branch lines or as a new project, has reached such a stage of completion that it is, or may be, regularly operated for the purposes of a common carrier, expenditures proper to be included in the accounts representing the cost of road and equipment should be charged directly to the accounts prescribed in the Classification of Expenditures for Road and Equipment, and not to the accounts in this classification.

2. **INCLUSION OF ALL ADDITIONS, BETTERMENTS, AND DEDUCTIONS.**—The accounts herein provided should include the cost of additional land, buildings, structures, and facilities, not taking the place of any property of like purpose previously held by the accounting carrier; the cost of newly acquired equipment; the cost of im-

proving land, buildings, structures, facilities, and equipment by additions thereto not involving the replacement of the property improved; the excess cost of improved buildings, structures, or facilities (except land and equipment) over the cost of replacing in kind structures and facilities of like purpose demolished, abandoned, or withdrawn from service; and the necessary credits to represent property abandoned, sold, or otherwise retired from service.

3. **EXCLUSION OF DISCOUNTS.**—When the consideration actually given for anything, with respect to which a charge is made to any account in this classification, is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of the consideration at the time of the transaction. No discount on securities or other commercial paper should be included in the cost of any property or improvement. Provision is made, however, in account A 34, "Interest and Commissions," for the inclusion in that account of bona fide interest accruing during the period of construction on money borrowed and expended for additions and betterments, but it should not be construed to cover any interest in excess of that accruing on the amount necessary for actual additions and betterments, between the time when the money becomes available and the time when the property acquired or improved is completed or received or available for the service for which it is intended.

4. **PROPERTY RETIRED AND REPLACED.**—When property (other than land or equipment), a betterment of which would be chargeable to the accounts of this classification, is abandoned, demolished, or otherwise retired from service for the purpose of or by reason of its replacement by property of like purpose of a better kind or a higher type,

the cost of replacing in kind the property so abandoned or withdrawn from service, less the salvage, if any, should be charged to Operating Expenses. If, however, a reserve for abandonment, as provided in paragraph 8 of these instructions, or a reserve for accrued depreciation has been created with respect to such property, the reserve account should be first debited with an amount equal to the credits thereto made with respect to the property abandoned or withdrawn and replaced; but if no reserve has been created in advance of the retirement of such property and the amount chargeable to Operating Expenses is relatively large, so much of the amount as may be authorized under the conditions outlined in paragraph 9 may be carried in suspense for distribution to the operating expenses of succeeding years.

5. **PROPERTY RETIRED AND NOT REPLACED.**—When property (other than equipment), an addition to or a betterment of which would be chargeable to the accounts of this classification, is abandoned or withdrawn from service and not replaced, the cost (estimated, if not known) should be credited to the account provided herein for such property; proper account should be taken of any salvage; the reserve accounts for abandonment and accrued depreciation should be debited with the amounts, if any, previously credited thereto with respect to the property abandoned or withdrawn, and the difference between the salvage plus the reserves and the cost should be charged to Profit and Loss, to which should also be charged any incidental expenses connected with the retirement.

6. **LAND SOLD OR ABANDONED.**—If any land, except land the cost of which may be classified under "Miscellaneous Investments" in the Form of General Balance Sheet Statement, First Revised Issue, is abandoned or its use discontinued, the original cost of the land (estimated, if not known) should be credited to the appropriate accounts

under Additions and Betterments and charged, less salvage from sale or other disposal, if any, to Profit and Loss. If the land is retained by the carrier, it should be charged at a fairly appraised value to an appropriate account to be included under "Miscellaneous Investments" in the Form of General Balance Sheet Statement, First Revised Issue.

7. EQUIPMENT.—Accounting rules relative to the cost of equipment acquired and equipment retired are contained in the text for account A 33, "Equipment."

8. RESERVES FOR ABANDONMENTS.—If so authorized upon application to the Interstate Commerce Commission, a carrier may set up accounts under Maintenance of Way and Structures in Operating Expenses with respect to important pieces of property (except equipment) to be abandoned, for the purpose of creating such reserves as will, at the time of the abandonment, meet or reduce the amounts otherwise chargeable to Operating Expenses or to Profit and Loss. Upon the abandonment of any property with respect to which a reserve has been created, such portion of the amount otherwise chargeable to Operating Expenses or to Profit and Loss as will equal the amount previously credited to the reserve account should be debited thereto.

9. DISTRIBUTION OF CHARGES FOR ABANDONED PROPERTY.—In case the amount chargeable to operating expenses for property abandoned directly in connection with improvements is relatively large, and its inclusion in a carrier's operating expenses for a single year would unduly burden those accounts for that year, a carrier may, if so authorized upon application to the Interstate Commerce Commission, charge so much of the cost as may be authorized to an account "Property Abandoned, Chargeable to Operating Expenses," as provided in the Form of General Balance Sheet Statement, First Revised Issue. The amount so charged should thereafter be apportioned to the operating expenses of succeeding

years, the number of which will be determined when permission to use the account is given.

**10. CONVERSION OF PROPERTY FROM ONE CLASS TO ANOTHER.**—When a building, structure, or facility of one class is converted to another class, its cost (estimated, if not known) should be credited to the appropriate account under Additions and Betterments; and such cost, less depreciation and the cost of any abandoned part of the property, should be charged, together with the cost of improvements which add to the value of the property, to the Additions and Betterments account under which it is classified after conversion. If any part of such property is abandoned, the cost of such part should be treated as is provided for property abandoned in paragraph 4 or 5 of these instructions.

**11. DEFINITION OF "COST OF REPLACING IN KIND."**—By the term "Cost of replacing in kind," as used in this classification is meant the cost, at the current prices of labor and material, of renewing such property by the construction or installation of other property substantially similar in capacity, service, and accessories, and having a physical condition and an expectation of life in service equal to that of the replaced property when acquired, or, if improved after acquirement, when in its best condition. It should not be construed as requiring an estimate based upon the current prices of material identical with that of which the thing abandoned was constructed, particularly when such material is no longer obtainable except at prohibitive prices and would not be used if a renewal of the property without betterment were undertaken.

**12. TREATMENT OF ABANDONED PROPERTY WHEN COST IS UNDERSTATED.**—In case a specific piece of property, abandoned subsequently to June 30, 1907, had been, previously to that date, so improved through charges to Income, Profit and Loss, or Operating Expenses, that the book value or record value is much less than the actual

cost of the property, a carrier may, upon filing with the Inter-state Commerce Commission a full description of the property and of the proposed improvements which require its abandonment and a comprehensive statement explanatory of the conditions which justify such treatment, and upon receiving the approval of the Commission, accept such book value as a basis for computing the amount to be charged to Operating Expenses with respect to the property abandoned. The amount to be charged to Operating Expenses under such conditions should be the same proportion of the cost of replacing the property in kind as the book value is of the total actual cost.

13. **OPTION IN CERTAIN CASES INVOLVING LESS THAN \$200.**—If the total amount chargeable to any account herein provided (unless it is specifically excepted from this option) is less than \$200 for any improvement considered as a whole, the option may be exercised of charging the amount expended to Operating Expenses as a renewal or to the appropriate account in this classification. This is not to be construed as authorizing the parceling of expenditures in order to bring them within this limit. If any unit of property the cost of which is less than \$200 is abandoned and not replaced, the option may be exercised (unless the accounts covering such property are specifically excepted from this option) of making no credit entry with respect to such abandonment.

14. **RECLASSIFICATION OF CHARGES.**—The net increase or decrease in the investment as reflected by these accounts should be reclassified in accordance with the accounts provided in the Classification of Expenditures for Road and Equipment, it being required that all items affecting additions and betterments be closed into the Road and Equipment accounts.

15. **INCIDENTAL SERVICES OF EMPLOYEES.**—No charge should be made against Additions and Betterments for incidental services of officers and employees whose time

is regularly devoted to other operations. If employees are specially assigned to additions and betterments work, their salaries and necessary expenses connected with that work should be included in its cost. In the redistribution of the expenditures covered by this classification in accordance with the Classification of Expenditures for Road and Equipment, engineering expenses should be charged to account No. 1, "Engineering," and not to the accounts representing the specific work under construction or improvement.

16. SALVAGE FROM EQUIPMENT, TOOLS, ETC.—When the cost of any work equipment, machinery, tools, or materials and supplies has been charged to accounts representing the cost of work involving additions and betterments and the entire value thereof has not been consumed in the work, the residual value of such work equipment, machinery, tools, or materials and supplies should be credited upon the completion of the work to the accounts affected and charged to the appropriate equipment or material accounts.

17. RESERVE FOR ACCRUED DEPRECIATION.—The accounts heretofore referred to as "Replacement" accounts should hereafter be kept under the name of "Reserve for Accrued Depreciation." The total of the credit balances in these accounts for depreciation on equipment and other property is required to be shown under this title on the balance-sheet statement. All debits to Operating Expenses (or other accounts) for depreciation should be concurrently credited to the appropriate accounts representing the Reserve for Accrued Depreciation on the classes of property for which the charges are made.

18. CANCELLATION OF CONFLICTING PREVIOUS INSTRUCTIONS.—This Classification supersedes the Classification of Expenditures for Additions and Betterments for Steam Roads, First Issue; and the rules herein provided supersede conflicting instructions in any other classifications previously issued.





## TEXT OF CLASSIFICATION OF EXPENDITURES FOR ADDITIONS AND BETTERMENTS.

### A 1. RIGHT OF WAY AND STATION GROUNDS.

To this account should be charged the cost of land (of necessary width conformable to depth and slope of excavations and embankments, including borrow pits and waste banks adjoining right of way) acquired for roadbed for additional main tracks; for new roadbed on account of changes of line, and for the construction of new and the extension of existing sidings and spur tracks; for additional station, terminal, and shop grounds, including land for ingress to or egress from such grounds; also for additional docks or wharves, and the cost of riparian or water rights necessary therefor.

The cost of stakes used to denote right-of-way limits; expenses of appraisals or of juries, commissioners, or arbitrators in condemnation cases; cost of removal of buildings from additional right of way or station, shop, and terminal grounds purchased; commissions paid to outside parties for the purchase of additional right of way and grounds for the purposes above described; notarial fees, cost of plats, abstracts, recording deeds; salaries and expenses of counsel, right-of-way agents, engineers, and assistants, when they are specially assigned to duties pertaining to the acquisition of right of way and station grounds; payments for right of way and station grounds on constructed lines, the title to which lands had not been acquired and payment for which had not been made before the construction accounts were closed; and payments for damages to abutting property caused by the construction of additional tracks, etc., as above described, should also be charged to this account. (See account A 17, "Elimination of Grade Crossings.")

NOTE A.—Proceeds from the sale of improvements included in a purchase of real estate, the cost of which is included in "Right of Way and Station Grounds," should be credited to this account.

NOTE B.—The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

## A 2. REAL ESTATE.

To this account should be charged the cost of additional land (except for right of way and station, shop, and terminal grounds), acquired for use in the company's operations as a carrier, and the cost of real estate acquired in the purchase of additional right of way and station, shop, and terminal grounds, but in excess of the land required for such purposes. This account should also include incidental expenses (or the proper proportion thereof), as enumerated in account A 1, incurred in the purchase of real estate chargeable to this account.

NOTE A.—In case the purchase of land for right of way and station grounds involves the acquisition of real estate that is not required for such purposes, the actual value of the real estate in excess of that required for right of way and station grounds, or an estimate of its salable value at the time of the purchase, should be charged to this account.

NOTE B.—When property charged to the "Real Estate" account becomes a part of a carrier's right of way or station grounds the amount originally charged should be credited to this account and charged to account A 1, "Right of Way and Station Grounds."

NOTE C.—Proceeds from the sale of improvements included in a purchase of real estate, the cost of which is included in the "Real Estate" account, should be credited to the same account.

NOTE D.—This account does not apply to real estate, the title to which is not held in the name of the railway company, to any acquired for investment purposes only, or to any not used in a carrier's operations, unless acquired as a part of land that is bought for such purposes.

NOTE E.—The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

## A 3. WHENING CUTS AND FILLS.

To this account should be charged the cost of increasing the width and slope of established cuts and fills, excavating in order to convert tunnels into open cuts, and filling in order to convert bridges, trestles, and culverts into fills. It includes the cost of grading, clearing, grubbing, and material and incidental expenses not necessary to the maintenance of the cuts and fills as previously established.

NOTE.—The cost of restoring banks to the established width, slope, or grade should be charged to the appropriate operating expense accounts. The cost of work done in the execution of a general plan of increasing the standard width and slope of embankments should be divided between Operating Expenses and Additions and Betterments, the charge to Operat-

ing Expenses being such proportion of the total cost as the estimated number of yards of material required to restore the banks to the original standard bears to the total number of yards moved in the work. There should also be charged to Operating Expenses the cost of dressing the slopes of cuts and fills, reditching cuts, replacing berm ditches, and necessary repairs to track, ballast, etc.

#### A 4. PROTECTION OF BANKS AND DRAINAGE.

To this account should be charged the cost of additional construction of a permanent nature, such as piling, cribbing, riprap, walls, breakwaters, levees, canals, dams, and other devices for the protection of roadbed, tracks, embankments, cuts, slopes, and other property used in the operation of a road from erosion or inundation by water. It does not include the cost of structures or devices of a temporary character installed for the immediate relief from or as a safeguard against damage by water.

NOTE: The cost of riprap at culvert ends or around bridge abutments or piers, to prevent washing or scouring, is chargeable to account A 7, "Bridges, Trestles, and Culverts," when not properly an operating expense.

#### A 5. GRADE REDUCTIONS AND CHANGES OF LINE.

To this account should be charged:

For grade reductions (cutting down summits and raising sags without materially changing the alignment): The cost of additional grading, including the rent and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, or streets, including crossing gates, alarms, and watchhouses; less the cost of replacing in kind grades or other property abandoned or removed.

For changes of alignment (alteration of alignment for the purpose of reducing curvature, cutting out bridges, tunnels, etc.): The excess cost of the grading, bridging, tunneling, etc., necessary for the change, over the cost of replacing in kind the grade, bridges, tunnels, etc., abandoned.

For changes of line (construction of new lines for the purpose of improving grade or alignment): The difference between the cost of the new line and the cost of replacing in kind the line abandoned, excluding the cost of right of way for both lines, but including the cost of engineering, clearing,

grubbing, and grading; tunnels, bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; fencing right of way; crossings and signs, interlocking and signal apparatus; telegraph and telephone lines; also cost of tools, rent and cost of operation of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

NOTE A. The cost of such grading as is necessary to restore banks or cuts to the original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting traffic while passing over the tracks; reballasting, lining, and surfacing tracks on completion of the work; moving and replacing rip-rap or other bank protection; and moving and relocating telegraph or telephone poles, signals, fences, buildings, etc., should all be charged to the appropriate operating expense accounts.

NOTE B. The cost of buildings, water and fuel systems, and similar structures on a changed line should not be charged to this account, which is intended to cover the road-way and track work, but should be charged to the appropriate accounts herein provided for the different classes of buildings and structures.

#### A 6. TUNNEL IMPROVEMENTS.

To this account should be charged the excess cost of enlarged tunnels (except to provide for additional main tracks) over the cost of replacing in kind the smaller tunnels; the excess cost of lining tunnels with stone, brick, or concrete over the cost of replacing in kind a less durable lining removed; and the cost of ventilating and lighting apparatus and of other safety devices, except guard rails and signals, added to tunnels.

NOTE. If a tunnel is converted into an open cut, the cost of clearing, grubbing, and excavating (including the cost of disposing of the excavated material) should be charged to account A 3, "Widening, Cuts and Fills." The cost of removing the lining of the tunnel, of protecting tracks and rails while the lining is being removed, and of restoring the tracks to proper condition for operation should be charged to the appropriate operating expense accounts.

#### A 7. BRIDGES, TRESTLES, AND CULVERTS.

To this account should be charged the excess cost of new bridges, trestles, and culverts carrying tracks over streams, ravines, streets, or other railways, over the cost of replacing in kind bridges, trestles, or culverts removed or abandoned.

including the cost of abutments, piers, supports, draw and pier protection; machinery to operate drawbridges; guard rails; inspection of material; tests; wing walls to abutments and culverts, masonry or concrete ends for culverts, riprap at culvert ends or around abutments; piers, dams, cribs, ice breakers; and painting (except repainting). It includes, also, the cost of additional parts or appurtenances and the excess cost of improved parts or appurtenances of bridges, trestles, and culverts over the cost of replacing in kind parts or appurtenances removed.

NOTE A. The cost of removing old material and protecting traffic during improvements should be charged to Operating Expenses.

NOTE B. When a bridge or trestle, or part of a bridge or trestle, is converted into a fill the cost, estimated, if not known, of the bridge or trestle if completely filled, or of such part of it as may be filled, should be credited to this account and charged, less salvage, to Operating Expenses. Such part of the original structure as would equal in cost the temporary trestling that would have been necessary to the construction of the fill in the first instance should be considered as salvage. The cost of filling, including such salvage, should be charged to account A 3, "Widening Cuts and Fills."

The cost of constructing bridges, trestles, or culverts where none previously existed, made necessary by the stopping up of natural waterways by the construction of embankments, should be charged to this account; the cost of that part of the embankment removed being credited to account A 3, "Widening Cuts and Fills," and charged to the appropriate operating expense account, which should also be charged with the cost of removing the embankment.

NOTE C. When the construction of new bridges, trestles, or culverts is made necessary by reason of grade reductions or changes in line or the building of additional main tracks, sidings, spur tracks, or terminal yards, or by such work as elimination of grade crossings, or reconstruction of road purchased, the cost thereof should not be included in this account, but in the account under which is classified the cost of the work that makes necessary the construction of the bridges, trestles, or culverts.

#### A 8. INCREASED WEIGHT OF RAIL.

To this account should be charged the excess cost of heavier rails applied to existing tracks, over the cost of rails of the same weight as the original pattern of the rails replaced, the cost to be based upon the price per ton (including freight and inspection) of the rails used in relaying the tracks.

NOTE A. The cost of distributing, laying, spiking, and jointing rails, surfacing and lining track, and picking up and removing old rails should be charged to Operating Expenses.

**NOTE B.**—In cases where the rails first applied to any tracks were second-hand rails and no more than the actual cost of such rails is carried in the accounts representing the cost of road and equipment, the excess cost of new rails or heavier rails used for relaying the tracks over the cost at prices current at the time of replacement of rails of a weight and condition equal to the weight and condition of the released rails, when applied, may be charged to this account.

**NOTE C.**—If the rails released from a carrier's main tracks are utilized in relaying the tracks of its branch lines, sidings, or spurs, previously laid with rails of a lighter pattern, the entire salvage value of rails so applied, less salvage from rails so replaced, may be charged to Operating Expenses as renewals, if the carrier deems it proper so to do.

#### A 9. IMPROVED FROGS AND SWITCHES.

To this account should be charged the excess cost of heavier frogs and switches over the cost of replacing in kind frogs and switches removed, the charge to be based upon the excess weight of the frogs and switches put in, if bought by weight. If the frogs and switches are of an improved (or patented) type, the excess cost of such frogs and switches over the cost of replacing those removed with others of the same pattern should be charged to this account.

**NOTE A.**—The cost of distributing new frogs and switches and picking up and loading frogs and switches removed in the course of betterment work should be charged to Operating Expenses.

**NOTE B.**—No entry is required in this account with respect to improved frogs and switches unless they are installed under a definite plan of improvement, such as increasing the weight of rail.

#### A 10. TRACK FASTENINGS AND APPURTENANCES.

To this account should be charged the cost of additional track fastenings and appurtenances and the excess cost of heavier or improved track fastenings and appurtenances over the cost of replacing in kind similar material removed, such as nuttoreepers, anglebars, connecting rods, guard rails (except on bridges, trestles, and culverts), guard-rail clamps and fasteners, nuts, nut locks, rail braces, rail chairs, rail slips, rail joints, splice bars, tie plates, and like material.

**NOTE A.**—The cost of distributing and applying new track fastenings and appurtenances and of picking up and loading material removed in the course of betterment work should be charged to Operating Expenses.

**NOTE B.**—No entry is required in this account with respect to improved track fastenings and appurtenances, unless they are applied under a definite plan of improving the tracks.

## A 11. BALLAST.

To this account should be charged the cost of ballasting tracks not previously ballasted, and the excess cost of ballasting other tracks over the cost of restoring to its maximum height the ballast previously put on the roadbed. It includes the cost of broken stone, slag, gravel, or other material especially provided for ballast; and the expense of loading (except when necessary to dispose of waste material such as cinders from cinder pits), hauling, and unloading, including the rent and expenses of locomotives and cars and the pay of crews engaged in hauling and distributing; cost of spreading ballast and putting it under track, and cost of tools used in this work.

NOTE. The cost of keeping tracks passable for traffic while being ballasted should be charged to the appropriate operating expense accounts.

## A 12. ADDITIONAL MAIN TRACKS

To this account should be charged the cost (excepting cost of right of way) of new second or other additional main tracks built alongside existing main tracks or built as additional main tracks during a change in the location of the existing main track or tracks. It includes the cost of engineering; clearing and grubbing; grading; tunnels (either new tunnels or the enlargement of existing tunnels to accommodate additional track or tracks); bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; interlocking and signal apparatus; also the cost of tools, the rent and expenses of locomotives and cars, and the pay of crews employed on the work.

NOTE A.—If, in constructing additional main tracks, it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct farm, country road, or street crossings, including crossing gates, alarms and watchhouses, the cost of such work should be charged to the appropriate operating expense accounts.

NOTE B. When a change of line is undertaken and more main tracks are laid on the new line than there were on the abandoned line, such portion of the cost of building the new line as represents the additional cost caused by providing the additional main tracks should be charged to this account and not to account A 5, "Grade Reductions and Changes of Line."

### A 13. SIDINGS AND SPUR TRACKS.

To this account should be charged the cost (except cost of right of way) of additional spur tracks, passing tracks, side tracks, and additional tracks in yards other than yards at division or train terminal points, and the cost of extending existing tracks of the kinds mentioned. This account includes engineering expenses; clearing and grubbing; grading; the cost of bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; interlocking and signal apparatus; also the cost of tools, the rent and expenses of locomotives and cars, and the pay of crews employed on the work. It does not include the cost of tracks in shop buildings or enginehouses, on transfer tables or turntables, tracks leading from transfer tables or turntables to shop buildings or enginehouses, tracks on inclines to fuel stations, or to and in ballast pits and ballast quarries.

**NOTE A.**—Expenditures made for the construction of branch lines are to be charged in accordance with the Classification of Expenditures for Road and Equipment. Branch lines are defined as lines serving one or more stations beyond the point of junction with main line or another branch line, to or from which stations regular tariff rates are in effect. Spur tracks are defined as lines constructed to reach or serve industries, such as mills, mines, smelters, factories, etc., over which regularly scheduled passenger or freight train service is not performed, and for transportation over which only a switching charge, if any, is made.

**NOTE B.**—If, in the construction of additional or in the extension of existing passing tracks, side tracks, or spurs, it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct firm, country-road, or street crossings, including crossing gates, signs, and watchhouses, the cost of such work should be charged to the appropriate operating expense accounts.

**NOTE C.**—The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

### A 14. TERMINAL YARDS.

To this account should be charged the cost (except the cost of right of way) of additional terminal yards and the cost of enlarging existing terminal yards at or near the terminus of roads or divisions or at junctions with branch lines, in which trains are made up and dispatched and cars sorted and stored. It includes engineering expenses; clearing, grubbing, and grading; the cost of bridges, trestles, and culverts;



ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; interlocking and signal apparatus; also the cost of tools, the rent and expenses of locomotives, steam shovels, and cars, and the pay of crews employed on the work.

**NOTE A.**—When it is necessary to rearrange or relocate existing tracks in order to enlarge a terminal yard, the cost of such work should be charged to Operating Expenses.

**NOTE B.**—If, in the construction of additional or the enlargement of existing terminal yards, it is necessary to remove or relocate telegraph or telephone poles or lines, fences, track signs or signals, buildings or other structures, or other tracks; or to relocate or reconstruct farm, country road, or street crossings, including crossing gates, alarms, and watch-houses, the cost of such work should be charged to the appropriate operating expense accounts.

**NOTE C.**—The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

#### A 15. FENCING RIGHT OF WAY.

To this account should be charged the cost of board, wire, rail, hedge, stone, or other fences along the right of way or limits of roadbed not previously fenced, including crossing gates, cattle guards, and wing fences thereto.

**NOTE A.**—No charge should be made to this account for fences constructed on a change of line (see account A 5, "Grade Reductions and Changes of Line") around stock yards, fuel stations, station grounds, and shops, or on other properties outside the right of way. The cost of additional permanent or portable fences for the protection of tracks from snow or sand should be charged to account A 31, "Snow and Sand Fences and Snowsheds."

**NOTE B.**—The \$200 minimum referred to in paragraph 13 of the General Instructions does not apply to amounts to be included in this account.

#### A 16. IMPROVEMENT OF CROSSINGS UNDER OR OVER GRADE.

To this account should be charged the cost of improvements made to existing overhead bridges or subways carrying roads, highways, or streets over or under tracks. It includes the excess cost of improved overhead bridges or parts of bridges over the cost of replacing in kind existing bridges or parts of bridges; the cost of additions to overhead bridges made necessary by the construction of additional main tracks, sidings, spur tracks, and terminal yards, or the extension of existing ones, including the excess

cost of new approaches to such bridges over the cost of replacing the approaches abandoned or removed; the cost of improvements to the roadway of existing overhead bridges and subways, including the roadway on the approaches thereto. If the extension of a bridge requires the alteration or modification of the existing structure, the excess cost of the improvement over the cost of replacing in kind the parts removed should be charged to this account.

**NOTE A.**—The cost of taking down abutments, piers, posts, etc., of overhead bridges and rebuilding them in new locations should be charged to the appropriate operating expense accounts.

**NOTE B.**—The cost of improving bridges and trestles carrying tracks over streets should be charged to account A 7, "Bridges, Trestles, and Culverts," and the cost of substituting overhead bridges or subways under tracks for existing grade crossings should be charged to account A 17, "Elimination of Grade Crossings."

**NOTE C.**—When subways or underground crossings are built in connection with grade reductions or changes of line, or the construction or extension of existing main tracks, sidings, and spur tracks, or terminal yards, the cost of the subways and of the bridges carrying the tracks over them should be charged to the appropriate account as a portion of the cost of such tracks or work.

#### A 17. ELIMINATION OF GRADE CROSSINGS.

To this account should be charged the cost of eliminating grade crossings by carrying railroads, streets, highways, country roads, or farm crossings over or under a carrier's tracks. It includes the cost of land necessary for the relocation of tracks, streets, or roads; damages to adjacent property and expenses of any litigation incidental thereto; the cost of elevated structures, retaining walls, or subways for carrying tracks over or under streets or roads; overhead bridges and subways (except when at stations and not public highways) carrying streets or roads over or under tracks; lowering or raising railway tracks, depots, platforms, and other buildings; grading approaches to subways and bridges; changing locations of streets or roads, and expenses incidental to such work, such as grading, paving, changing sewers, drains, water and gas pipes, and the like; and other necessary expenses for the elimination of crossings at grade.

**NOTE A.**—The cost of all repairs to tracks, raising or lowering them as filling or excavation progresses; keeping them in condition to handle traffic, and protecting traffic thereon; ballasting on completion of work (if previously ballasted); repairs to interlocking, block, and other signal systems, includ-

ing the elevation or depression thereof during the progress of work, and other similar expenses, should be charged to the appropriate operating expense accounts.

**NOTE B.**—Amounts collected from States, municipalities, or others as their contributions to or proportion of the cost of eliminating grade crossings should be credited to this account.

#### A 18. INTERLOCKING APPARATUS.

To this account should be charged the cost of additional interlocking plants or apparatus, and the excess cost of enlarged or improved interlocking plants or apparatus over the cost of replacing in kind interlocking plants or apparatus removed. It includes the cost of labor and of material, such as levers, racks, wires, pulleys, semaphores, semaphore signals, ground signals, posts, box troughs, and other fixtures; towers, power plants, batteries, wire, and other necessary material. If the improvement or enlargement of interlocking apparatus involves a partial destruction and reconstruction of the plant, the excess cost of the improvement or enlargement over the cost of replacing in kind the parts removed should be charged to this account.

**NOTE A.**—This account does not include the cost of additional or enlarged interlocking plants or apparatus made necessary by grade reductions and changes of line or by the building of additional main tracks, sidings, and spur tracks, or terminal yards.

**NOTE B.**—The cost of changing connections or locations of semaphores and other signals in the course of betterment work should be charged to Operating Expenses.

#### A 19. BLOCK AND OTHER SIGNAL APPARATUS.

To this account should be charged the cost of additional apparatus for all classes of block or other stationary signals. It includes the cost of labor and of material, such as levers, racks, wires, pulleys, semaphores, semaphore signals, ground signals, posts, box troughs, and other fixtures; and the cost of towers and offices or houses (other than station buildings) for block and signal operators; bonding rails; signal bells, including crossing alarm bells; power plants; batteries and wires; and other necessary appliances.

To this account should also be charged the excess cost of improved systems of block and other signal apparatus over the cost of replacing in kind existing signal apparatus.

**NOTE.**—The cost of altering or changing any system of block or other signals to connect two or more signal systems so that they may be operated as one system, and the cost of changing connections or locations during betterment work, should be charged to the appropriate operating expense account.

#### A 20. TELEGRAPH AND TELEPHONE LINES.

To this account should be charged the cost of additional telegraph and telephone lines, including the cost of conduits, poles, cables, wires, billets, insulators, tie wires, instruments, and other material; also the cost of labor employed and tools used in this work. To it should also be charged the cost of additional telegraph and telephone wires on existing pole lines.

When an improved wire is substituted for an inferior wire, the excess cost of the improvement over the cost of replacing in kind the wire removed should be charged to this account.

#### A 21. STATION BUILDINGS AND FIXTURES.

To this account should be charged the cost of additional station buildings or structures (except when classified as dock and wharf property), and the cost of additional fixtures, furniture, and facilities necessary to equip such new buildings for service or to enlarge the equipment of existing station buildings and structures; also the excess cost of new buildings or parts of buildings or new furniture, fixtures, and facilities over the cost of replacing in kind buildings or parts of buildings, furniture, fixtures, and facilities removed. It includes such items as architect's fees, cost of beautifying grounds, drainage systems, electric fixtures and wiring, elevators, excavations, fences, gas fixtures, foot-bridges (not highways), furniture, grading, heating apparatus, hedges, icing stations, paving, platforms, piping, pumps, sidewalks, stationary scales, station signs, stock pens, stoves, subways, turnstiles, water fixtures, and wells.

NOTE.—The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

#### A 22. ROADWAY MACHINERY AND TOOLS.

To this account should be charged the cost of roadway machinery and tools (except hand and other small portable tools liable to be lost or stolen) not taking the place of machinery and tools of like purpose previously held. It includes the cost of machinery (not permanently mounted on wheels and considered as equipment), such as dredging, ditching, grading, pile-driving and steam-shovel machinery, and the cost of motor cars and other apparatus and instruments of special value used in the maintenance of roadway and for which a record is kept showing the person or persons responsible for their safe keeping.

NOTE A.—The cost of hand and other small portable roadway tools, liable to be lost or stolen, and roadway machinery and

appliances of which no record is kept, should be charged, when acquired, to an appropriate Materials and Supplies account, from which they should be charged, as issued, to the appropriate operating expense or other accounts.

NOTE B.—A record should be kept of any property charged to this account, and when it is retired from service from any cause the cost should be credited to this account, and such cost, less salvage and the amount reserved for depreciation, if any, charged to Operating Expenses.

#### A 23. SHOPS, ENGINEHOUSES, AND TURNTABLES.

To this account should be charged the cost of additional shops, enginehouses, and turntables, and of additional fixtures, facilities, and appurtenances (other than shop machinery and tools) necessary to equip them; also the excess cost of new buildings or structures or parts of buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind like property removed.

This account should include the cost of the following buildings or structures when built as parts of or for use in connection with shops, enginehouses, and turntables: Car sheds, cinder pits, drop pits, electric light and power plants, out-houses, sand houses, scrap bins, storehouses, tracks, and transfer tables; also the cost of the following items incidental to the construction or improvement of the buildings or structures mentioned: Architects' fees, beautifying grounds, excavations, foundations, electric fixtures, fences, gas fixtures, grading, heating plants and apparatus, hedges, platforms, sewerage systems, sidewalks; turntable levers, tractors, and stops; and water system connections.

NOTE.—The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

#### A 24. SHOP MACHINERY AND TOOLS.

To this account should be charged the cost of machinery and tools installed in shops or enginehouses and not replacing other tools and machinery, including foundations therefor, the cost of transportation, loading, unloading, and placing machinery in position. This account includes the cost of additional stationary engines and boilers, automatic stokers, ash conveyors; electric generators and motors, switchboards, compressors; shafting, belting; cranes; stationary and portable forges; trip hammers, lifting magnets,

and hydraulic, pneumatic, and electric machines; and other machinery and tools installed in shops and enginehouses, including the necessary small hand tools first to equip them, but not including additional small hand tools furnished to shops or enginehouses already in operation.

To it should also be charged the excess cost of machinery and tools (except hand and other small portable tools) of an improved type or character installed in shops or enginehouses over the cost of replacing in kind machinery or tools abandoned. The excess cost of foundations for new machinery over the cost of replacing in kind the foundations for existing machinery and the cost of unloading and placing the machinery thereon, should be charged to this account.

#### A 25. WATER AND FUEL STATIONS.

To this account should be charged the cost of additional structures used as, or in connection with, stations for supplying locomotives with water or fuel; also the excess cost of new structures or parts of structures of this class over the cost of replacing in kind structures removed. The following items are chargeable to this account:

For water stations: Boilers, cisterns, dams, engines, and fixtures; fences, foundations, penstocks and connections, pipe lines and piping, pumps, pump houses, purifying plants, settling basins, stand pipes, tanks, tubs, track tanks or troughs, wells, windmills, and other machinery and appliances necessary to operate water stations.

For fuel stations: Ash handling plants, buckets, cranes, chutes, dumping machinery, elevators, engines (stationary), fences, platforms, scales, sheds, tippie cars, wood racks, fuel-oil plants, inclines at fuel stations and tracks on same, and other machinery and appliances necessary to operate fuel stations.

NOTE A.—This account should not include waterworks, wells, fuel stations, coal houses, etc., used exclusively for supplying water or fuel to shops, power plants, stations, hotels, and tenement or section houses, which should be charged to the appropriate accounts.

NOTE B.—The cost of restoring the condition of grounds after betterment work, including the filling of abandoned wells and cisterns, should be charged to Operating Expenses.

#### A 26. GRAIN ELEVATORS AND STORAGE WAREHOUSES.

To this account should be charged the cost of additional grain elevators and storage warehouses, including the cost of

foundations, conveyors, machinery, and fixtures therein; the cost of additional conveyors, machinery, and fixtures for such existing buildings; also the excess cost of improved machinery, fixtures, etc., over the cost of replacing in kind existing machinery, fixtures, etc. When such buildings are altered or enlarged, the excess cost of the improvement over the cost of replacing in kind the parts abandoned or removed should be charged to this account.

NOTE A.—The cost of filling foundations and restoring the condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

NOTE B.—The buildings referred to in this account are not small storage elevators at way stations or ordinary freight warehouses where freight is received for shipment, etc., but large elevators in which a regular grain business is handled or grain is stored for various owners, and warehouses in which merchandise is stored. Small storage elevators at way stations are classed as station buildings.

#### A 27. DOCK AND WHARF PROPERTY.

To this account should be charged the cost of additional docks, wharves, landings, slips, float bridges, and inclines to transfer steamers, and the cost of buildings, structures, coal and ore handling machinery, and other necessary facilities erected as additions to existing docks or wharves or in connection with the construction of additional docks or wharves. It includes also the cost of additional slips and of piling, pile protection, cribs, cofferdams, walls, and other necessary devices and apparatus for the operation or protection of docks and wharves.

To this account should also be charged the excess cost of improved docks, wharves, landings, slips, float bridges, and inclines to transfer steamers, and of buildings, structures, coal and ore handling machinery, and other necessary facilities on docks and wharves over the cost of replacing in kind like property abandoned or removed.

NOTE A.—The cost of restoring the condition of docks or wharves and land upon which they are situated after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

NOTE B.—The cost of land on which additional wharves are built and of riparian or water rights for docks and wharves should be charged to account A 1, "Right of Way and Station Grounds."

## A 28. ELECTRIC LIGHT AND POWER PLANTS.

To this account should be charged the cost of additional electric light and power plants (except those used exclusively for furnishing light or power to office buildings, or to station grounds and buildings, or to shop grounds and buildings), including the cost of buildings, dynamos and generators, condensers and transformers, boilers and engines, switchboards, storage batteries, poles, insulators, and wires for electric lines; glass globes, electric lamps, hangers for lights, and other material necessary first to equip them. It includes also the cost of power houses and ear sheds at power plants; flowage rights; dams, reservoirs, penstocks, water wheels or turbines, pumps, and other machinery, and the foundations therefor; and other construction expenses necessary for the erection of new and additional electric light and power plants, and the excess cost of improved plants, buildings, machinery, and appurtenances over the cost of replacing in kind like property removed.

When the improvement involves a modification or alteration of existing structures, there should be charged to this account the excess cost of the improvement over the cost of replacing in kind the parts abandoned.

NOTE.—The cost of restoring the condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

## A 29. ELECTRIC-POWER TRANSMISSION.

To this account should be charged the cost of additional systems for the transmission of electricity for power purposes, including span, guard, feed, and overhead trolley wires; poles, cross-arms, brackets, insulators, and connections; third rails, including braces, supports, and devices for insulating, covering, or protecting; bonding rails, including connecting plugs, insulating mats, plugs, or other devices; switchboards, switches, cut-outs, transformers, etc. (not at power stations or substations), and other expenditures necessary for the building of additional lines for the transmission of electric power.

To this account should also be charged the excess cost of improved transmission lines or parts of lines over the cost of replacing in kind property of like purpose abandoned.

## A 30. GAS-PRODUCING PLANTS.

To this account should be charged the cost of additional gas-producing and gas-compressing plants; the cost of addi-



tional machinery and appliances for such plants; and the excess cost of improved plants, machinery, or appliances, over the cost of replacing in kind like property abandoned. If an improvement requires the alteration or modification of existing structures, there should be charged to this account the excess cost of the improvement over the cost of replacing in kind the parts removed.

**NOTE.**—The cost of restoring the condition of grounds after betterment work should be charged to the appropriate account under Operating Expenses or Outside Operations.

#### A 31. SNOW AND SAND FENCES AND SNOWSHEDS.

To this account should be charged the cost of additional snowsheds, including rock filling when necessary, and permanent or portable fences for the protection of tracks from snow and sand.

**NOTE.** When permanent snow or sand fences take the place of existing right-of-way fences, the entire cost of the new fences should be charged to this account, the original cost (estimated, if not known) of the right-of-way fences removed being credited to account A 15, "Fencing Right of Way," and charged, together with the cost of removal, less salvage, to the appropriate operating expense account.

#### A 32. RECONSTRUCTION OF ROAD PURCHASED.

When a railroad is purchased and the property (other than equipment) acquired is in such a physical condition that it is necessary substantially to rebuild the road within one year after its acquisition, in order to bring it up to the standard required by the purchasing company, such part of the cost of rebuilding as will, when added to the amount paid for such property, equal the cost of replacing the property as rebuilt, should be charged to this account, and any excess of the cost of such property plus the cost of rebuilding over the cost of replacing it as rebuilt, should be charged to Profit and Loss; if the work of rebuilding is not done within one year after the date of acquisition, the cost of any improvements should be charged to the other accounts in this classification, subject to the conditions prescribed for improvements of other property.

If, however, the work of reconstruction referred to above is necessarily delayed to a time more than one year after the acquisition of the property, and the purchasing company desires to make the improvements under the conditions named and to include the cost in this account, it may

file with the Interstate Commerce Commission a description of the property acquired and a comprehensive statement showing the amount paid for the road purchased, the appraised value of the physical property acquired, the amount which it is proposed to expend upon improvements, and the nature of the improvements necessary to be made and other pertinent facts, and upon approval of the Commission the cost of the improvement may be disposed of as indicated.

Equipment acquired as part of the property of a road purchased should not be included in this account, but the appraised value at the time of acquisition should be charged to account A 33, "Equipment."

#### A 33. EQUIPMENT.

To this account should be charged the cost of all newly acquired equipment, such as steam locomotives, electric locomotives, passenger-train cars, freight train cars, work equipment (for general use), floating equipment, and the necessary appurtenances, fixtures, and furniture first to fit out for service, including the cost of inspection, settling up, and trying out, and transportation over foreign lines; also, the cost of additional devices and apparatus applied to equipment, such as electric headlights, power brakes, vestibules, machinery for self-propulsion, heating and lighting apparatus, and the like; and the excess cost of improved appliances and parts or appurtenances over the cost of replacing in kind the appliances and parts or appurtenances removed.

To this account should be credited the original cost (estimated, if not known) of any equipment destroyed, sold, or otherwise permanently retired from service; but if the value (the original cost) of any equipment as carried in the accounts representing the cost of equipment has been written down in consideration of depreciation accrued previously to July 1, 1907, the depreciated value at that date instead of the original cost should be credited to this account; proper account should be taken of any salvage; and the "Reserve for Accrued Depreciation" account should be debited with an amount equal to the amount previously credited thereto with respect to the equipment retired. The difference between the actual depreciation (original cost or depreciated value on July 1, 1907, less salvage) and the reserve for accrued depreciation should be charged to the appropriate account in Operating Expenses, if the difference is due to depreciation in service since July 1,

1907; to Profit and Loss if due to depreciation in service before that date; and, if not readily assignable, the amount should be prorated between Operating Expenses and Profit and Loss on the basis of the time in service after and before that date.

When any equipment is in such physical condition that it must be practically rebuilt in order to fit it for service, or when any equipment requires repairs which, if made, would constitute the major portion of its value, it should, when taken out of service, be considered as retired and be written out of the accounts as provided in the preceding paragraph; upon being rebuilt, the cost of replacing in kind the equipment as rebuilt (consideration being given to second hand parts remaining therein) should be charged to this account.

NOTE A. When important additions and betterments project or the construction of new lines necessitate the purchase of work equipment to be used exclusively thereon, the cost of such equipment should be included in the accounts representing the cost of the work, and no charge should be made to Operating Expenses for depreciation on such equipment while the cost remains so charged. The amount realized from any subsequent sale, or the appraised value of the equipment retained after the completion of the special work for which it was purchased, should be credited to the accounts charged with its cost. The appraised value of such equipment retained should be debited to this account, and thereafter, for the purposes of this account, such appraised value should be considered as the cost of the equipment.

NOTE B. When any equipment is changed into equipment of another class, as a freight train car into a work car, and the change involves a partial destruction and partial reconstruction of the equipment altered, the excess cost of the new parts or appurtenances over the cost of replacing in kind those removed should be charged to this account. If no betterment is involved in the change, the difference between the cost or record value and the depreciated value at the date of change should be credited to this account. In either case, the Reserve for Accrued Depreciation account should be debited with an amount equal to the accrued depreciation previously credited thereto with respect to the equipment changed, and thereafter depreciation should be based upon the appraised value after the change in the class to which converted. The cost of dismantling the old equipment and such part of the cost of making the change as does not distinctly better it should be charged to Operating Expenses.

### A 31. INTEREST AND COMMISSIONS.

When any bonds, notes, or other evidences of indebtedness are sold, or any interest-bearing debt is incurred for additions

and betterments purposes, the interest that accrues on such part of the debt as represents the cost of property chargeable to additions and betterments (less interest, if any, allowed by depositories on unexpended balances) after such funds become available for use and before the receipt or the completion or coming into service of the property so acquired should be charged to this account.

If any bona fide allowance is made or brokerage paid to agents or factors for services rendered in the sale of bonds, notes, or other evidences of indebtedness issued for additions and betterments purposes, there should be charged to this account such proportion of the brokerage or commission so paid as the amount expended for and chargeable to Additions and Betterments bears to the whole amount realized from the sale of the securities.

**NOTE A.**—Interest on bonds, notes, or other evidences of indebtedness, accruing before the proceeds from the sale of the securities become available for use, should not be included in this account nor should there be included any interest accruing after the property with respect to which the proceeds are expended is received or becomes available for use.

**NOTE B.**—If any securities which have been issued or assumed by the carrier (except securities which have been sold and reacquired) are sold or exchanged by or for the carrier for a consideration the actual money value of which, at the time of such sale or exchange, is less than the value of the securities at par and the accrued interest thereon, if any, the difference between the money value of the consideration received and the par value of the securities plus the accrued interest shall be deemed a discount and in no case should discounts be included as part of the cost of anything charged to any account prescribed in this classification.

#### A 35. OTHER ADDITIONS AND BETTERMENTS.

To this account should be charged the cost of additional structures or facilities, not taking the place of property of like purpose previously held, and the excess cost of enlarged or improved structures and facilities over the cost of replacing in kind like property retired from service by reason of the improvements, when such cost is proper, under the general rules governing this classification, to be included in Additions and Betterments and is not classifiable under any of the foregoing accounts in this classification. This account should not be charged with any amount with respect to unapplied materials and supplies, or property which may not be readily identified

and inventoried, such as wood ties of a better grade replacing those of an inferior grade; or assessments by towns, cities, or other governmental authorities against a carrier as a property holder for public improvements which do not directly benefit the carrier in the operation or maintenance of its property.

NOTE. All entries in this account are required to be shown in such detail in Annual Reports to the Interstate Commerce Commission as will denote the character of the improvement made or the property acquired by the expenditures charged to this account.





FORM OF  
GENERAL RELEASE STATEMENT

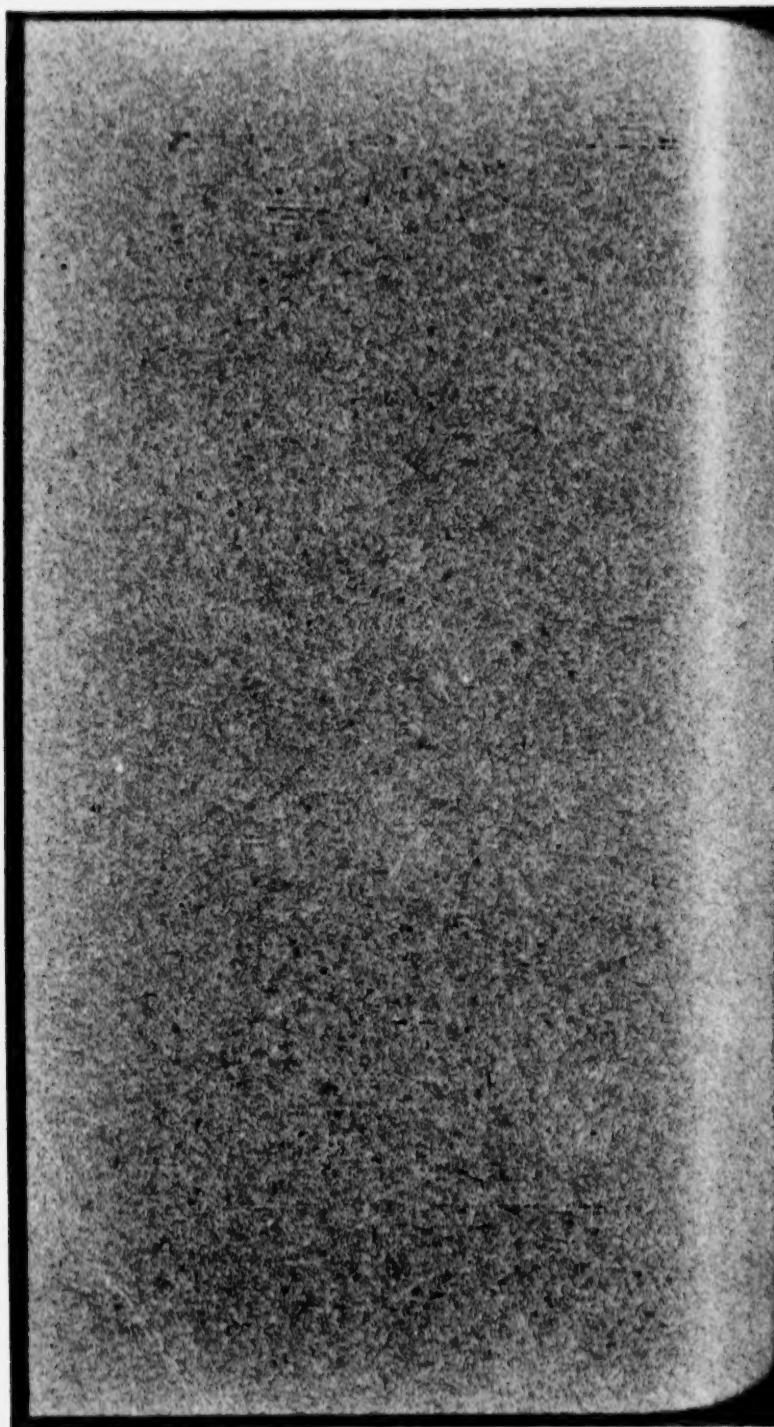
DEPARTMENT OF COMMERCE

STEAM ROADS

SECTION 20 OF THE ACT TO REGULATE  
COMMERCE

RIGHT REVISED JANUARY

1900





FORM OF  
GENERAL BALANCE SHEET STATEMENT

AS PRESCRIBED BY THE  
INTERSTATE COMMERCE COMMISSION  
FOR

STEAM ROADS

IN ACCORDANCE WITH  
SECTION 20 OF THE ACT TO REGULATE  
COMMERCE

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FIRST REVISED ISSUE

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*Effective on June 15, 1910*

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WASHINGTON  
GOVERNMENT PRINTING OFFICE  
1910



THE INTERSTATE COMMERCE COMMISSION.

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MARTIN A. KNAPP, *of New York.*

JUDSON C. CLEMENTS, *of Georgia.*

CHARLES A. PROUTY, *of Vermont.*

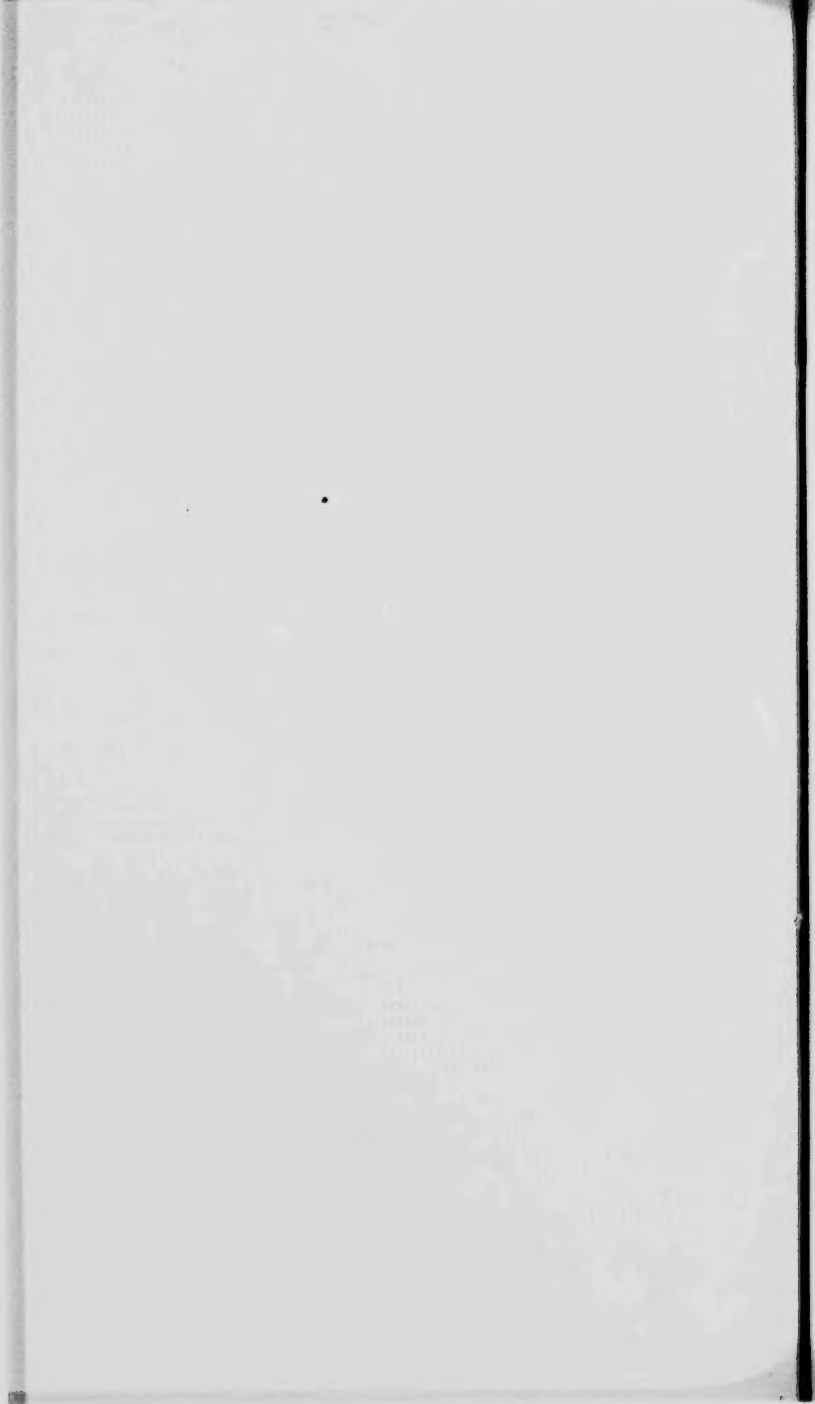
FRANCIS M. COCKRELL, *of Missouri.*

FRANKLIN K. LANE, *of California.*

EDGAR E. CLARK, *of Iowa.*

JAMES S. HARLAN, *of Illinois.*

EDWARD A. MOSELEY, *Secretary.*



At a General Session of the INTERSTATE COMMERCE  
COMMISSION, held at its Office in Washington, D. C.,  
on the 31st day of May, 1910.

*Present:*

MARTIN A. KNAPP,	} Commissioners.
JUDSON C. CLEMENTS,	
CHARLES A. PROUTY,	
FRANCIS M. COCKRELL,	
FRANKLIN K. LANE,	
EDGAR E. CLARK,	
JAMES S. HARLAN,	

The subject of a Uniform General Balance Sheet Statement for the use of carriers making reports to the Commission, and of the Ledger Accounts immediately pertaining thereto, being under consideration, the following order was entered:

*It is ordered.* That the Form of General Balance Sheet Statement, with the classification of the accounts involved in such statement and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form, to be hereafter known as Form of General Balance Sheet Statement, First Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

*It is further ordered,* That the said Form of General Balance Sheet Statement, First Revised Issue, with the classification of the accounts involved in such statement and the text pertaining thereto, be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906, in the keeping and recording of all transactions reflected in the said Form of General Balance Sheet Statement, First Revised Issue; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts involved in the said Form of General Balance Sheet Statement, First Revised Issue, in conformity therewith; and that a copy of the said Form of General Balance Sheet Statement, First Revised Issue, be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

*It is further ordered,* That the rules contained in the said Form of General Balance Sheet Statement, First Revised Issue, are, and by virtue of this order do become, the lawful rules according to which all entries in the accounts involved in such statement are defined; that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of all transactions pertaining to, or reflected in, the said Form of General Balance Sheet Statement, First Revised Issue; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier, or for any person directly in charge of the accounts of any such carrier, or of any receiver or operating trustee of any such carrier, to keep any account or record or memorandum of any transactions pertaining to, or reflected in, the said Form

of General Balance Sheet Statement, First Revised Issue, except in the manner and form hereby prescribed: *Provided, however,* That nothing in this order shall be construed as depriving a carrier of the right to make whatever analysis of balance-sheet entries it may deem proper for the information of stockholders or of officials who have the management of its property.

*It is further ordered,* That June 15, 1910, be, and is hereby, fixed as the date on which the said Form of General Balance Sheet Statement, First Revised Issue, shall become effective.

A true copy:

EDW. A. MOSELEY,  
*Secretary.*





## INTRODUCTORY LETTER.

INTERSTATE COMMERCE COMMISSION,  
BUREAU OF STATISTICS AND ACCOUNTS,  
*Washington, May 31, 1910.*

### TO CARRIERS CONCERNED:

The Form of General Balance Sheet Statement, First Issue, was promulgated under date of June 21, 1909, and carriers were advised that it would be incorporated in the forms for annual reports to the Interstate Commerce Commission for the year ending June 30, 1910, unless modified by an order of the Commission before that date.

On December 15, 1909, there was issued Special Report Series Circular No. 9, in which was required a statement of assets and liabilities as of June 30, 1909, in accordance with the form mentioned above. In connection with the report in this circular, criticisms and suggestions were requested pertinent to the making of such corrections or emendations as would not involve the fundamental principles established. The consideration of the returns thus obtained has led to some modifications embraced in the present revision.

The revised form as now issued will be incorporated in the forms for the annual reports of carriers concerned for the year ending June 30, 1910.

HENRY C. ADAMS,  
*In charge of Statistics and Accounts.*



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## EXPLANATORY NOTE.

The accounts prescribed in the Form of General Balance Sheet Statement are, in some instances, net balances or the sums of balances from other accounts. It is not required that all the accounts prescribed in this classification shall be kept under the exact titles given to the accounts herein prescribed, but it is required that the accounts necessary to record the transactions reflected herein shall be kept, it being permissible to keep such additional accounts as may be necessary to make any further analysis of the balance-sheet entries desired by the respondent company.

The term "cost or book value," as applied to various accounts representing securities owned, is intended to recognize the option of the respondent company of carrying its investments in securities either at cost or at a reasonable valuation other than cost. Whenever securities are acquired, they are to be entered on the books at cost. If, subsequently, the company desires to adjust their value on account of substantial appreciation or depreciation, the entries in its books with respect to such securities, as well as its annual reports to the Commission, should clearly show the reasons for making the adjustments.

Contingent assets and liabilities should not be included in the body of the balance-sheet statement, but should be shown in detail in a supplementary statement accompanying the balance sheet. Contingent assets represent possible sources of value contingent upon the fulfillment of conditions regarded as uncertain. Contingent liabilities include obligations which may, under certain conditions, become obligations of the respondent company but are neither direct nor assumed obligations on the date of the balance sheet.

# TEXT EXPLANATORY OF ACCOUNTS APPEAR- ING IN THE GENERAL BALANCE SHEET STATEMENT

## ASSETS.

### PROPERTY INVESTMENT.

#### I. ROAD AND EQUIPMENT.

##### B 1-A. Investment to June 30, 1907.

This account should include the balances carried in the General Ledger showing the book value of Road and Equipment as it stood on June 30, 1907, subdivided between (a) Road and (b) Equipment, when the subdivision can be accurately made.

##### B 1-B. Investment since June 30, 1907.

This account should include the cost of all property, classifiable as Road and Equipment or Additions and Betterments, acquired since June 30, 1907, less deductions for property abandoned. The amount included herein should be subdivided: (a) Road, (b) Equipment, (c) General Expenditures.

NOTE.—When any equipment is acquired under a contract of installment or any agreement which provides that the cost shall be paid in installments, the cost (its cash value at time of purchase) should be charged to Additions and Betterments at the time of its acquisition and included in the foregoing accounts in the same manner as is the cost of equipment purchased outright. When the par value of notes or other securities issued in payment, or in part payment, for such equipment is more (or less) than the actual cash value of the equipment at the time of the purchase, or of the proportion to which the securities are applicable, the difference between the par value of the securities and the actual cash value of the equipment, or of the proportion paid for by the securities, should be credited (or charged) to the proper Discounts and Premiums accounts. (See account B-29.)

##### B 1-C. Reserve for Accrued Depreciation—Cr.

This account should include amounts charged, with respect to equipment or other property in service at the date of the balance sheet, to Operating Expenses (or to other accounts) to cover depreciation on such property.

\* The total of accounts B 1-A and B 1-B should be drawn down by the balance-sheet statement and the amount of account B 1-C deducted therefrom, the difference being shown as the total of Road and Equipment.

## II. SECURITIES.

### B 2. Securities of Proprietary, Affiliated, and Controlled Companies—Pledged.

This account should include the cost or book value of securities of proprietary, affiliated, and controlled companies whose property is used by or forms a part of the railway system of the respondent company, which securities are pledged as collateral security for any of the respondent company's funded debt or other outstanding obligations. It should also include the cost or book value of securities of union depot, terminal, bridge, ferry, and similar companies whose property is used by the respondent company in the transaction of its own transportation business, when said securities are pledged as security for outstanding obligations.

Amounts reported in this account should be classified under the subheadings: (a) Stocks, (b) Funded Debt, (c) Miscellaneous.

### B 3. Securities Issued or Assumed—Pledged.

This account should include the par value of securities issued by the respondent company and of securities issued by other companies, the payment of which has been assumed by the respondent company, that have been pledged as collateral for other securities issued.

The par value of securities reported in this account should also be included in liabilities under the general account "Stock" or "Mortgage, Bonded, and Secured Debt."

Amounts reported in this account should be classified under the subheadings: (a) Stocks, (b) Funded Debt, (c) Miscellaneous.

NOTE.—This account is not intended to cover securities that are merely guaranteed.

### B 4. Securities of Proprietary, Affiliated, and Controlled Companies—Unpledged.

This account should include the cost or book value of unpledged securities of proprietary, affiliated, and controlled companies whose property is used by or forms a part of the railway system of the respondent company, the securities being held for the purpose of preserving the integrity of the system. There should also be included in this account the cost or book value of securities of union depot, terminal,



bridge, ferry, and similar companies whose property is used by the respondent company in the transaction of its own transportation business, when said securities are unpledged.

Amounts reported in this account should be classified under the subheadings: (a) Stocks, (b) Funded Debt, (c) Miscellaneous.

NOTE.—This account is not intended to cover securities that are considered as "Marketable Securities."

### III. OTHER INVESTMENTS.

#### B 5. Advances to Proprietary, Affiliated, and Controlled Companies for Construction, Equipment, and Betterments.

This account should include the balances in open accounts, representing cash advanced to proprietary, affiliated, and controlled companies to enable such companies to pay for construction, equipment, and additions and betterments when such advances are of a permanent nature or when it is understood and intended that the respondent company shall be reimbursed by issuing to it the debtor company's securities, and that such securities when received shall be charged to account B 2 or account B 4.

NOTE.—Advances to cover any expenditures that may not properly be charged to the accounts prescribed in the Classification of Expenditures for Road and Equipment and for Additions and Betterments, should not be charged to this account but to account B 17 (a). Advances for the purposes stated in the text of this account, the amount of which it is proposed to recover in cash or in securities not necessary for corporate control, which may be sold or held as free assets, should also be included in account B 17 (a).

#### B 6. Miscellaneous Investments.

(a) *Physical Property*.—This account should include investments of a permanent nature in physical property other than that held for the operation of the company's property as a transportation agency. It should include such items as investments in coal and other mines, mineral and timber lands, saw-mills and other manufacturing plants, lands and other property acquired and held in anticipation of future use, second-hand and other rails and track material leased to industries or to tram or other roads not owned or controlled by the respondent company, buildings (not used in transportation operations) held for rent, and other property, not a part of the company's plant for the maintenance and operation of the property devoted to furnishing transportation and facilities incidental thereto.

(b) *Securities—Pledged*.—This account should include investments, not provided for in accounts B 2, B 3, and B 4, in securities pledged as collateral for other securities issued or assumed. It should include the cost or book value of securities held as permanent investments, such as securities of steamship lines, express companies, railway companies (not in the transportation system of the respondent company), and other enterprises, and memberships of permanent value in boards of trade and other commercial organizations.

(c) *Securities—Unpledged*.—This account should include investments, not provided for in accounts B 2, B 3, and B 4, in securities held unpledged and not held as marketable securities (account B 9). It should include the cost or book value of securities held as permanent investments, such as securities of steamship lines, express companies, railway companies (not in the transportation system of the respondent company), and other enterprises, and memberships of permanent value in boards of trade and other commercial organizations.

#### WORKING ASSETS.

##### B 7. Cash.

This account should include current funds in the hands of financial officers and agents, deposits in banks or with trust companies available for use on demand, including deposits to pay declared dividends or matured coupons, and cash in transit for which agents and conductors receive current credit.

##### B 8. Securities Issued or Assumed—Held in Treasury.

This account should include the par value of securities issued by the respondent company and the par value of securities issued by other companies, the payment of which has been assumed by the respondent company, that are held unpledged in the company's treasury or by its agents or trustees, except trustees of sinking funds or other similar funds.

The par value of securities reported in this account should also be included in liabilities under the general account "Stock" or "Mortgage, Bonded, and Secured Debt."

This account should be subdivided to show: (a) Stocks, (b) Funded Debt, (c) Miscellaneous.

NOTE A.—The term "Securities," as used in this account, includes all authorized certificates of stock and evidences of indebtedness which have been signed, sealed, and when required, certified by

the trustees under the mortgage or contract, and stocks, bonds, and other evidences of indebtedness, issued and assumed, which have been actually sold and reacquired. When any securities have been actually issued to bona fide holders for value, or after issue by another company have been assumed by the respondent company, and after such issue or assumption are reacquired under circumstances which require that they shall not be treated as paid or retired, they should be included in this account at par value; the difference between the par value and the amount paid in reacquiring such securities should be debited (or credited, as the case may be) to Profit and Loss, and any loss sustained or gain realized from the subsequent sale of such securities should be debited or credited to Profit and Loss, except that when securities issued or assumed by the company have been purchased for investment of sinking funds or similar funds they should be charged to the trustees of the funds at cost.

NOTE B.—This account is not intended to cover securities that are merely guaranteed.

#### B 9. Marketable Securities.

This account should include the cost or book value of all securities, except securities issued or assumed by the respondent company, held in the company's treasury unpledged and free for sale and not necessary or desirable for the respondent company to hold for the purpose of maintaining the integrity of its transportation system. These securities should be classified as (a) Stocks, (b) Funded Debt, and (c) Miscellaneous.

#### B 10. Loans and Bills Receivable.

This account should include the book value of all collectible obligations in the form of loans and bills receivable or other similar evidences of money receivable on demand or within a time not exceeding one year.

NOTE.—This does not include time loans which mature more than one year after date of issue, considered as investments, or loans to proprietary, affiliated, or controlled companies, such as are described under accounts B 5 and B 17 (a).

#### B 11. Traffic and Car-Service Balances Due from Other Companies.

This account should include the net amount due from other companies against each of which there is a net debit balance in the total of the accounts representing interline freight, passenger, and baggage revenues, and charges for equipment interchanged on a per diem or a mileage basis.

#### B 12. Net Balance Due from Agents and Conductors.

This account should include the net balance due in current accounts from agents and train, sleeping-car, and dining-car

conductors, train auditors, porters, and other employees and representatives charged with the collection or custody of current revenues.

NOTE.—Amounts advanced to general and special agents as working funds should not be included in this account but in account B 17 (b).

#### B 13. Miscellaneous Accounts Receivable.

This account should include amounts due for audited accounts considered good, such as those due from the United States or other governments for the transportation of mails and government property, and from express companies for express facilities furnished under contract; amounts due from other carriers on account of freight claims paid; miscellaneous bills against other railway companies, corporations, firms, and individuals, rents collectible; interest collectible on bills and accounts receivable, and on mortgages, deposits, and securities; dividends declared and collectible but not paid; and other similar items.

NOTE.—The amount to be reported under this account is not the net balance between accounts B 13 and B 37.

#### B 14. Materials and Supplies.

This account should include the balances representing the cost, less depreciation, if any, of all unapplied material, such as road and shop material, articles in process of manufacture by the company, stationery, dining-car and other commissary supplies, etc.

#### B 15. Other Working Assets.

This account should include items of working assets not covered by accounts B 7 to B 14, inclusive. It is intended to include asset items that have not reached the stage of audited accounts properly classed under account B 13, and yet have been advanced beyond the stage of accounts properly classed under account B 26. This account includes such items as claims in process of collection from parties at fault on account of fines imposed by postal authorities; amounts due from other roads for mileage or tickets honored for which reports or accounts have not been received from or rendered to other roads; advanced charges billed out on waybills not reported received at the end of the month; and other similar items.

## ACCRUED INCOME NOT DUE.

## B 16. Unmatured Interest, Dividends, and Rents Receivable.

This account should include the amount of dividends declared on stocks owned, dividends accrued on such stocks when contracts require that the dividends be paid at stated times, and interest on loans made and rents under leases, accrued to the date of the balance sheet but not due or collectible until after that date.

## DEFERRED DEBIT ITEMS.

## B 17. Advances.

(a) *Temporary Advances to Proprietary, Affiliated, and Controlled Companies.*—This account should include balances in open accounts representing cash advanced to proprietary and subsidiary companies, to enable such companies to pay interest on their funded debt, for deficits resulting from the operation of such companies, and for other purposes of a similar nature; also advances to proprietary, affiliated, and controlled companies to enable them to pay for construction, equipment, and additions and betterments, when it is understood and intended that the advances shall be repaid in cash or by issuing to the respondent company the debtor company's securities, and that such securities, when received, shall be sold or held in the treasury as free assets.

NOTE.—When the securities referred to in this account are to be held in order to maintain the integrity of the railway system, the amounts advanced should be included in account B 5, and transferred, when the securities are received, to account B 2, if pledged, or to account B 4, if not pledged.

(b) *Working Funds.*—This account should include amounts advanced to general and special agents, officers and employees of the engineering department, and other officers and employees as working funds from which certain expenditures are to be made and accounted for. It also includes advances to fast freight lines and union depot and other terminal companies as working funds to be used in paying the current expenses of such companies in advance of regular monthly settlements.

(c) *Other Advances.*—This account should include other advances not properly classifiable under (a) and (b) above or under account B 5.

**B 18. Rents and Insurance Paid in Advance.**

This account should include the balances in the accounts representing prepaid rents, which are to be charged to the appropriate rental accounts under Income as the term is consumed for which the rents are paid; also insurance premiums paid in advance of their accrual, which premiums are to be apportioned and charged, as they accrue, to appropriate expense account.

**B 19. Taxes Paid in Advance.**

This account should include the excess of taxes paid over the accrued amount properly chargeable against Income (or other accounts) to the date of the balance sheet.

**B 20. Unextinguished Discount on Securities.**

Ledger accounts should be raised to cover the discounts and premiums on each class of capital stock and each class of funded debt securities sold by the company. When securities which have been issued or assumed by the respondent company (except securities which have been sold and reacquired) are sold or exchanged, by or for the respondent company for a consideration the actual money value of which, at the time of such sale or exchange, is less than the value of the securities at par and the accrued interest thereon, if any, the discount suffered should be debited to the account raised for Discounts and Premiums on securities of the class to which those sold belong. (Premiums realized from such sale or exchange should be credited to the account so raised.) If the net balances in the accounts covering discounts and premiums on the different classes of capital stock sold and the different classes of funded debt securities sold be debit balances, they should be included in the balance-sheet statement as follows:

(a) *Unextinguished Discount on Capital Stock.*— If the net of the balances in the Discounts and Premiums accounts for all classes of capital stock sold is a debit balance, the amount should be stated in this account. This balance should be carried on the balance sheet until extinguished by premiums realized on subsequent sales of stock, by assessments levied on the stockholders, by appropriations of income or free surplus for the purpose, or by retiring the stock. When any stock is retired, the proper Discounts and Premiums account should be adjusted by crediting to it an amount equal to the unextinguished discount on such stock.

(b) *Unextinguished Discount on Funded Debt.*—If the net of the balances in the Discounts and Premiums accounts for all class *s* of funded debt sold is a debit balance, the amount should be included in this account. At or before the close of each fiscal period, there should be charged to Income (and credited to the Discounts and Premiums accounts in which the discount is carried) such proportions of the discount on outstanding debt obligations as may be applicable to that period. This proportion should be determined according to a rule the uniform application of which throughout the interval between the date of sale and the date of maturity will extinguish the discount on funded debt. In order that the discount may be extinguished earlier, the company may, at its option, charge to Profit and Loss all or any portion of the discount on funded debt remaining at any time unextinguished; but the charge to Income for any period must not exceed the proportion applicable to that period and a charge should be made for each period so long as any portion of the discount remains unextinguished.

NOTE A.—No two stocks should be considered as of the same class unless they are equal in their voting rights, their dividend or interest rights, and the conditions under which they may be retired. No two issues of funded debt should be considered as of the same class unless they have the same mortgage or other lien or security, rate of interest, interest dates, and date of maturity.

NOTE B.—In no case should discount on securities be charged to or included in any account as a part of the cost of acquiring any property, tangible or intangible.

#### B 21. Property Abandoned, Chargeable to Operating Expenses.

This account is intended as a suspense account to which may be charged certain costs representing important pieces of property abandoned because of improvement or betterment work when the cost of such property would, if included in the operating expenses for a single year, unduly burden such accounts for that year. It is to be used only after permission of the Interstate Commerce Commission has been asked and given and is not to be applied to lands abandoned or to equipment retired from service. Amounts included in the account are to be redistributed to operating expenses through a period of years, the number of which will be determined when permission to use the account is granted, and the balance remaining unextinguished on the date of the balance sheet should be included therein.

To this account (when authorized by the Interstate Commerce Commission) may be charged such amounts as are required by the Classification of Expenditures for Additions and Betterments to be charged to operating expenses for property abandoned because of additions and betterments work.

NOTE.—The phrase "unduly burden such accounts," used above, should not be interpreted as meaning that a carrier is at liberty to make charges for abandoned property directly to operating expenses, or to operating expenses through the account "Property Abandoned, Chargeable to Operating Expenses," in view of its financial ability to make such charges directly in one year and its inability to make such charges in another year.

#### B 22. Special Deposits.

This account should include amounts realized from the sale of securities and held by trustees for disbursement when the purposes for which the securities are sold are accomplished; amounts realized from the sale of property and held by trustees until the property is replaced; special deposits (other than in sinking funds) for the payment of debts and interest, not matured; also, money and securities (except securities included in accounts B 2, B 3, and B 6) deposited to insure the performance of contracts; and other deposits of a special nature not elsewhere provided for.

#### B 23. Cash and Securities in Sinking and Redemption Funds.

This account should include the amount of cash and the cost or book value of live securities in the hands of trustees of sinking and other funds for the purpose of redeeming outstanding obligations; also, amounts deposited with such trustees on account of mortgaged property sold.

#### B 24. Cash and Securities in Insurance and Other Reserve Funds.

This account should include the ledger balances covering the amount of cash and the cost or book value of securities in the hands of trustees or managers of insurance funds, depreciation funds, and other funds that have been raised and specifically set aside or invested by the company for specific purposes (except special deposits, provident funds, and sinking funds for the retirement of obligations).



#### B 25. Cash and Securities in Provident Funds.

This account should include the ledger balances covering the amount of cash and the cost or book value of securities in the hands of trustees or managers of employees' pension funds, savings funds, relief, hospital, and other association funds (whether contributed by the company, by employees, or by others), when such trustees or managers are acting for the company in the administration of such funds. If such funds are held in the company's treasury unidentified and not invested, they should be included in account B 7.

#### B 26. Other Deferred Debit Items.

In this account should be included suspense accounts showing debit balances that can not be entirely cleared and disposed of until additional information is received, such as freight claims paid when found to be correct, but in advance of investigation with other carriers; charges for work done or materials furnished for which bills have not been received from the proper departments; items awaiting adjustment between accounts, such as cost of work done in advance of receipt of proper authority or appropriation; accounts covering the cost of operation of gravel pits and quarries to be apportioned on output; debit balances in "Shop Expense" and "Store Expense" accounts; also amounts to be spread over a stated term not provided for in accounts B 20, B 21, or elsewhere, and debit balances in operating reserve accounts to be cleared by future charges to operating expenses.

### PROFIT AND LOSS.

#### B 27. Balance.

When the Profit and Loss account shows a debit balance the amount of which exceeds the appropriated surplus included in accounts B 48 and B 49, the amounts in those accounts should be stated on the credit side of the balance sheet in the item column only, and their total should be transferred to the debit side of the balance sheet immediately following Profit and Loss—Balance from which it should be deducted, the difference being extended as the net deficit. (See account B 50.)

## LIABILITIES.

## STOCK.

## B 28. Capital Stock.

This account should include the total par value of certificates or receipts issued to represent permanent interests in the respondent company or interests which, if terminable, are so only at the option of the company. The amounts included in this account should be divided so as to show: (1) The par value of certificates (pledged or unpledged) held in the company's treasury, by its agents or trustees, or otherwise subject to its control; (2) The par value of certificates issued and outstanding and not held by the company, its agents or trustees, or subject to its control.

The amounts included herein should be further subdivided so as to show the amount of each class of stock issued, as follows:

(a) *Common Stock*.—Stocks whose claims in the distribution of dividends are subordinate to the claims of all other stocks.

(b) *Preferred Stock*.—Stocks having a first claim upon such dividends as may be distributed.

(c) *Debtenture Stock*.—Stocks issued under a contract to pay a specified return at specified intervals.

(d) *Receipts Outstanding for Installments Paid*.—Receipts for payments on account of subscriptions to capital stock. When certificates are issued for amounts so paid, the par value should be included in the account covering the class of stock for which the certificates are issued.

NOTE A.—When a general levy or assessment is made against the holders of capital stock, requiring the payment of any sum for the use of the company in addition to the consideration agreed upon at the time of sale, the amount collected upon such levy or assessment should be credited to the Discounts and Premiums account for the class of stock on which the assessment is made.

NOTE B.—For the purposes of the balance-sheet statement, capital stock is considered as "issued" when certificates are signed and sealed and placed with the proper officer for sale and delivery. All capital stock issued and not canceled is considered to be "outstanding."

### B 29. Stock Liability for Conversion of Outstanding Securities of Constituent Companies.

This account should include the company's liability under agreements to exchange its capital stock for the outstanding securities of constituent companies whose physical property has been acquired under such agreements, but whose securities have not yet been surrendered for exchange.

### B 30. Premiums Realized on Capital Stock.

When any issue of capital stock is sold or exchanged by or for the respondent company for a consideration the actual money value of which exceeds the par value of the stock at the time of such sale or exchange, the premium so realized should be credited to a ledger account provided for discounts and premiums on the class of stock sold. (See account B 20.) If the net of the balances in the accounts for discounts and premiums on all classes of stock sold is a credit balance, the amount should be included in this account. This balance should be carried permanently on the balance sheet unless extinguished by discounts suffered on subsequent sales of stock or by retiring the stock. When any stock is retired, the proper Discounts and Premiums account should be adjusted by debiting it with an amount equal to the unextinguished premium on such stock.

## MORTGAGE, BONDED, AND SECURED DEBT.

### B 31. Funded debt.

There should be included in this account the total par value of outstanding funded debt issued by the respondent company, and the total par value of outstanding funded debt issued by other companies, the payment of which has been assumed by the respondent company.

The amounts included in this account should be divided so as to show: (1) The par value of certificates or other evidences of funded debt (pledged or unpledged) held in the company's treasury, by its agents or trustees, or otherwise subject to its control; (2) The par value of certificates or other evidences of funded debt issued and outstanding and not held by the company, its agents or trustees, or subject to its control.

The amounts included herein should be further subdivided as follows:

(a) *Mortgage Bonds*.—Bonds secured by a lien on the property of the company, except as provided in the other subdivisions of this account.

(b) *Collateral Trust Bonds*.—Bonds secured by a lien on securities or other commercial paper. Stock trust certificates that are similar in character to collateral trust bonds should be included under this heading, as should also all collateral trust notes.

(c) *Plain Bonds, Debentures, and Notes*.—Unsecured certificates of indebtedness. Short-term notes (having a date of maturity one year or less from date of issue) given in payment of temporary indebtedness should not be included under this heading. Short-term notes secured by collateral should be classed with collateral trust bonds. Debentures should be clearly distinguished from debenture stock.

(d) *Income Bonds*.—Bonds which are a lien on a carrier's revenue alone, or bonds which, while being a lien on the cars and franchises, are claim payment of interest only in case interest is earned.

(e) *Equipment Trust Obligations*.—Equipment bonds, equipment notes, or trust notes secured by a lien on specific equipment, such lien having been created in connection with the acquisition of the equipment securing the obligations.

(f) *Nonamortizing Funded Obligations*.—All funded obligations not provided for by the other subdivisions of this account, including real estate mortgages executed or assumed and other similar obligations.

(g) *Receipts Outstanding for Funded Debt*.—Receipts for payments on account of funded debt. When certificates are issued for amounts so paid, the par value should be included in the account covering the class of funded debt for which the certificates are issued.

NOTE.—For the purposes of the balance-sheet statement, bonds are considered as "issued" when they are certified by trustees and issued with the proper order for sale and delivery. All bonds issued and not canceled are considered to be "outstanding."

### B 32. Receivers' Certificates.

This account should include the par value of outstanding certificates, notes, or other obligations issued by receivers in charge of and operating the property of a carrier, and the par

value of certificates, notes, or other obligations issued by receivers and assumed upon reorganization.

### B 33. Obligations for Advances Received for Construction, Equipment, and Betterments

Proprietary, affiliated, and controlled companies should show in this account the amounts advanced to them for construction, equipment, and additions and betterments expenditures, when such advances are made by the controlling company under the conditions described in account B 5.

## WORKING LIABILITIES

### B 34. Loans and Bills Payable

This account should include the balances representing obligations outstanding in the form of loans and bills payable or other similar evidences of indebtedness payable on demand or within a time not exceeding one year from date of issue, except secured notes proper to be included in account B 31.

### B 35. Traffic and Car-Service Balances Due to Other Companies

This account should include the net amount due to other companies in favor of each of which there is a net credit balance in the total of the accounts representing interline freight, passenger, and baggage revenues, and charges for equipment interchanged on a per diem or a mileage basis.

### B 36. Audited Vouchers and Wages Unpaid

This account should include the amount of audited vouchers or accounts, and audited pay rolls unpaid on the date of the balance sheet. It should include balances representing unclaimed wages and outstanding pay and time or discharge checks issued in payment of wages.

### B 37. Miscellaneous Accounts Payable

There should be included in this account unpaid and outstanding drafts drawn by station agents, unpaid and outstanding drafts drawn on the company in settlement of freight claims, conductors' rebate and extra fare checks not presented for redemption, meal checks and tickets outstanding, deposits of controlled companies, and other items of the nature of demand liabilities not covered by accounts B 34, B 35, B 36, B 38, and B 39.

NOTE.—The amount to be reported under this account is not the net balance between accounts B 13 and B 37.

**B 38. Matured Interest, Dividends, and Rents Unpaid.**

This account should include the amount of dividends payable on capital stock and unpaid, uncalled for, or unclaimed at the date of the balance sheet, including dividends payable on the first day following that for which the balance sheet is made; the amount of matured and unpaid interest on the funded debt of the respondent company, and of other companies when payment has been assumed by the respondent company, including interest which matures on the first day following that for which the balance sheet is made; unpaid dividends on the stock and unpaid interest on the funded debt of other companies when same are payable by the respondent company as all or a portion of the rent due under leases; and all other rents due and payable for property held under leases.

**B 39. Matured Mortgage, Bonded, and Secured Debt Unpaid.**

This account should include the amount of matured mortgage, bonded, and secured debt payable but not yet paid, including bonds drawn for redemption through the operation of sinking and redemption fund agreements.

**B 40. Working Advances Due to Other Companies.**

Proprietary, affiliated, and controlled companies should include in this account the amounts advanced to them for general purposes, such as advances to pay interest on their funded debt (except interest proper to be included in account B 33), deficits resulting from their operation, and advances for construction, equipment, and additions and betterments, when such advances are made under the conditions stated in account B 17 (*a*).

**B 41. Other Working Liabilities.**

This account should include items of working liabilities not covered by accounts B 34 to B 40, inclusive. It should include liability items that have not reached the stage of audited liabilities and become actually payable, yet are obligations of the company and advanced beyond the stage of accounts properly classed under account B 47, such as retained percentages due contractors, to be paid on completion of contracts; deposits for construction of side tracks, to be refunded on the basis of an agreed percentage of the earnings from

the traffic handled over the tracks; prepaid charges billed out on waybills not taken into the month's accounts; and other similar items.

#### ACCRUED LIABILITIES NOT DUE.

##### B 42. Unmatured Interest, Dividends, and Rents Payable.

This account should include the amount of dividends on capital stock, interest on loans and funded debt, including interest on funded debt assumed, and rents under leases, accrued to the date for which the balance sheet is made but not payable until after the first day following that date. There should be included also as rents accrued, the amount of accrued dividends on the stock and accrued interest on the funded debt of other companies when such dividends and interest are paid as all or a portion of the rent under leases from those companies.

##### B 43. Taxes Accrued.

This account should include the amount of taxes accrued and charged against Income (or other accounts) in excess of the amount paid. When the respondent company leases the property of another company and, under the terms of the lease, agrees to pay or assume the taxes that may be levied upon or assessed against such property, the taxes accrued on such property should be included in this account and not in account B 42. When, however, the taxes are paid by the lessor company, the full amount of rent accrued to be paid by the lessee should be included in account B 42.

#### DEFERRED CREDIT ITEMS.

##### B 44. Unextinguished Premiums on Outstanding Funded Debt.

When any issue of funded debt is sold at a premium or issued for a consideration the actual money value of which, at the time of the sale of the funded debt, is greater than the par value of the securities sold and accrued interest thereon, if any, the premium so realized should be credited to a ledger account provided for discounts and premiums on the class of funded debt sold. (See account B 20.) If the net of the balances in the Discounts and Premiums accounts for all classes of funded debt sold is a credit balance, the amount should be included in this account. At or before the close of any fiscal period there should be credited to the Income of that period

(and debited to the Discounts and Premiums accounts in which the premium is carried) such proportions of the premiums on outstanding debt obligations as may be applicable to that period. This proportion may be determined according to a rule the uniform application of which throughout the interval between the date of sale and the date of maturity of the debt will extinguish the premium at which such debt was sold.

#### B 45. Operating Reserves.

This account should include the ledger balances representing reserves created by charges to Operating Revenues or to Operating Expenses to provide for overcharge, personal injury, insurance, and other claims, and for similar purposes.

NOTE.—The credit balances in reserve accounts representing appropriations of income or surplus for sinking funds, etc., should not be included in this account. (See account B 49.) Reserves for accrued depreciation of property are included in account B 1-c.

#### B 46. Liability on Account of Provident Funds.

This account should include the ledger balances covering the amount of cash and the cost or book value of securities in the hands of trustees or managers of employees' pension funds, savings funds, relief, hospital, and other association funds (whether contributed by the company, by employees, or by others), when such trustees or managers are acting for the carrier in the administration of such funds.

#### B 47. Other Deferred Credit Items.

Under this account should be included the amount of credit balances in suspense accounts that can not be entirely cleared and disposed of until additional information is received, such as collections by general agents and others to cover prepayment of shipments originating on the lines of other carriers; amounts realized from the sale of damaged, unclaimed, and over freight and held pending claim; switching charges of other carriers collected and held awaiting bills from such carriers; amounts received from the sale of mileage tickets to be disposed of as mileage is honored by the respondent or other carriers; amounts collected for milling-in-transit privileges, to be cleared when products are shipped; credit balances in "Shop Expense" and "Store Expense" accounts; and other similar items.



## APPROPRIATED SURPLUS.

## B 48. Additions to Property since June 30, 1907, through Income.

This account should include the total amount of appropriated Income or Surplus expended since June 30, 1907, in the acquisition of property and for improvements, the cost of which is proper, under the classifications prescribed for such expenditures, to be included in the accounts making up the total of Road and Equipment, such as the cost of property used in the company's operations as a carrier, the proportion of the cost of projects involving additions and betterments required to be included in such accounts; also, amounts of appropriated Income or Surplus expended since June 30, 1907, in the discharge of the principal (less the discount, if any, suffered at the time of sale) of any indebtedness incurred in the acquisition or improvement of property the cost of which is included in the Road and Equipment accounts.

NOTE.—This account is intended to include only appropriations of Income or Surplus definitely set aside for the acquisition of property or for improvements the cost of which should be included in the Road and Equipment accounts as shown on the balance sheet. When property is purchased or improvements made by an advance of cash which is intended to be replaced with the proceeds of a subsequent sale of securities, the amount so advanced should not be included in this account; nor should there be included advances not intended to be replaced by securities, unless the amounts advanced have been definitely appropriated and are considered appropriated surplus as distinguished from profit and loss balance.

## B 49. Reserves from Income or Surplus.

In this account should be grouped all appropriations of income or surplus held in reserve (except as covered by account B 46 and account B 48), including unexpended balances of appropriations from Income or Surplus for additions and betterments. This account should be subdivided under the following heads:

(a) *Invested in Sinking and Redemption Funds.*—Amounts charged against Income or Surplus for sinking fund or redemption fund payments, and accretions to such funds in the hands of trustees.

(b) *Invested in Other Reserve Funds.*

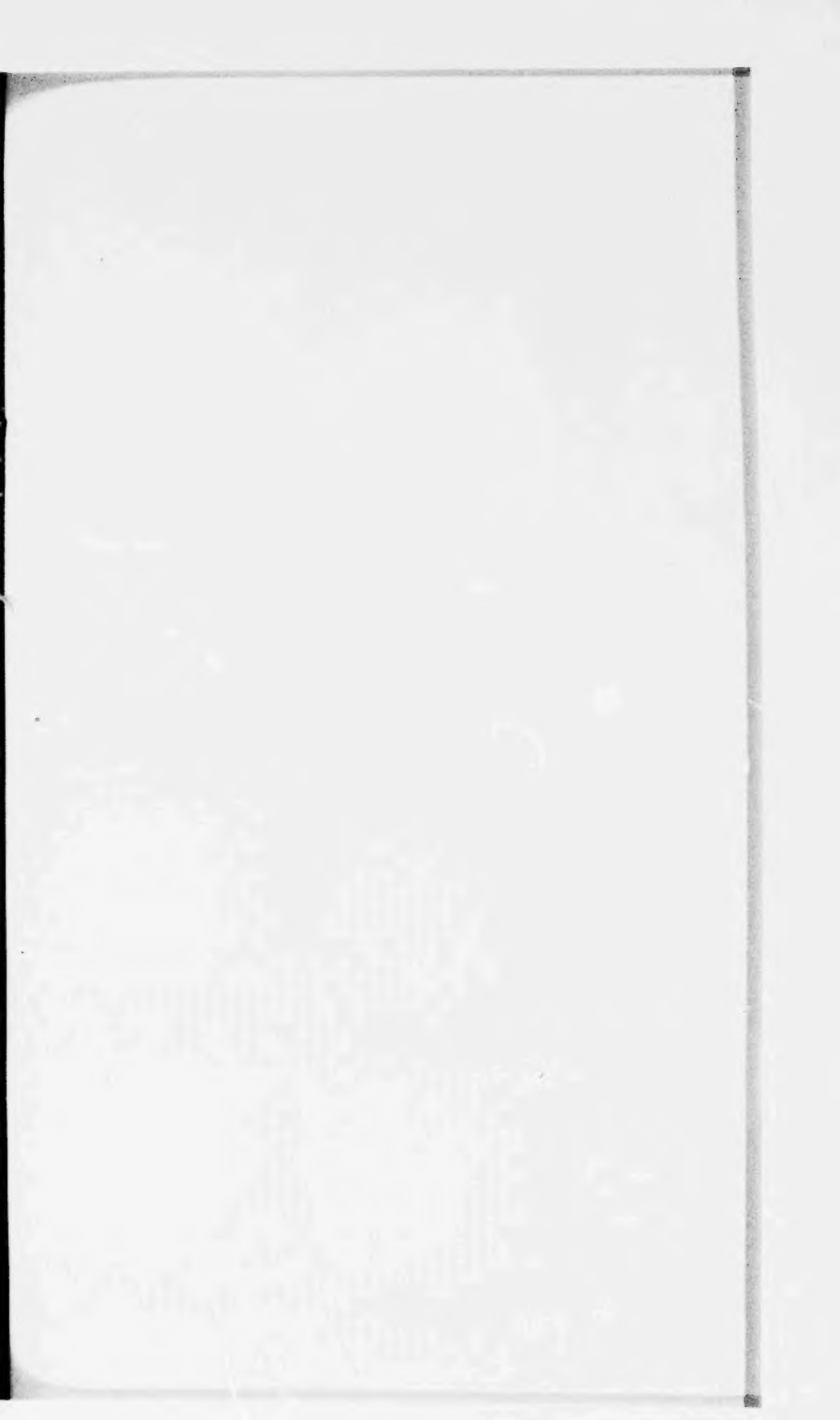
(c) *Not Specifically Invested.*

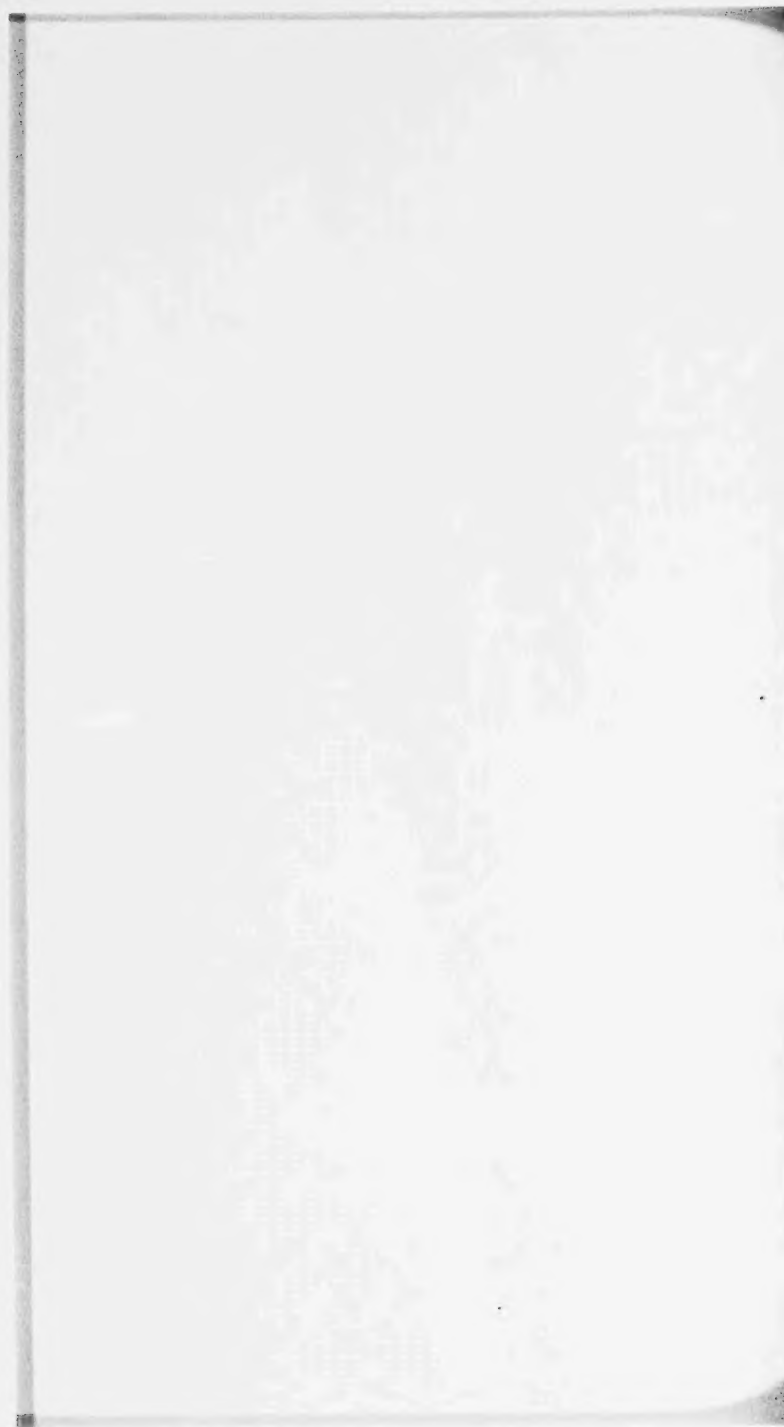
**PROFIT AND LOSS.****B 50. Balance.**

This account should include the credit balance in the Profit and Loss account.

When the Profit and Loss account shows a debit balance, the amount of which does not exceed the Appropriated Surplus included in accounts B 48 and B 49, the amounts in those accounts should be stated in the item column only, and the debit balance in Profit and Loss deducted from their total, the difference being extended to the total column as the net Appropriated Surplus. When, however, the debit balance in Profit and Loss exceeds the Appropriated Surplus as shown in accounts B 48 and B 49, the amounts in those accounts should be stated in the item column only, and the total of the two transferred to the assets side of the balance sheet as a deduction from the Profit and Loss debit balance on that side, the difference being extended as a net deficit. (See account B 27.)

**O**





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OX. 11

[This Classification amended by Supplement effective on July 1, 1908]

**CLASSIFICATION**  
**OF**  
**OPERATING EXPENSES**

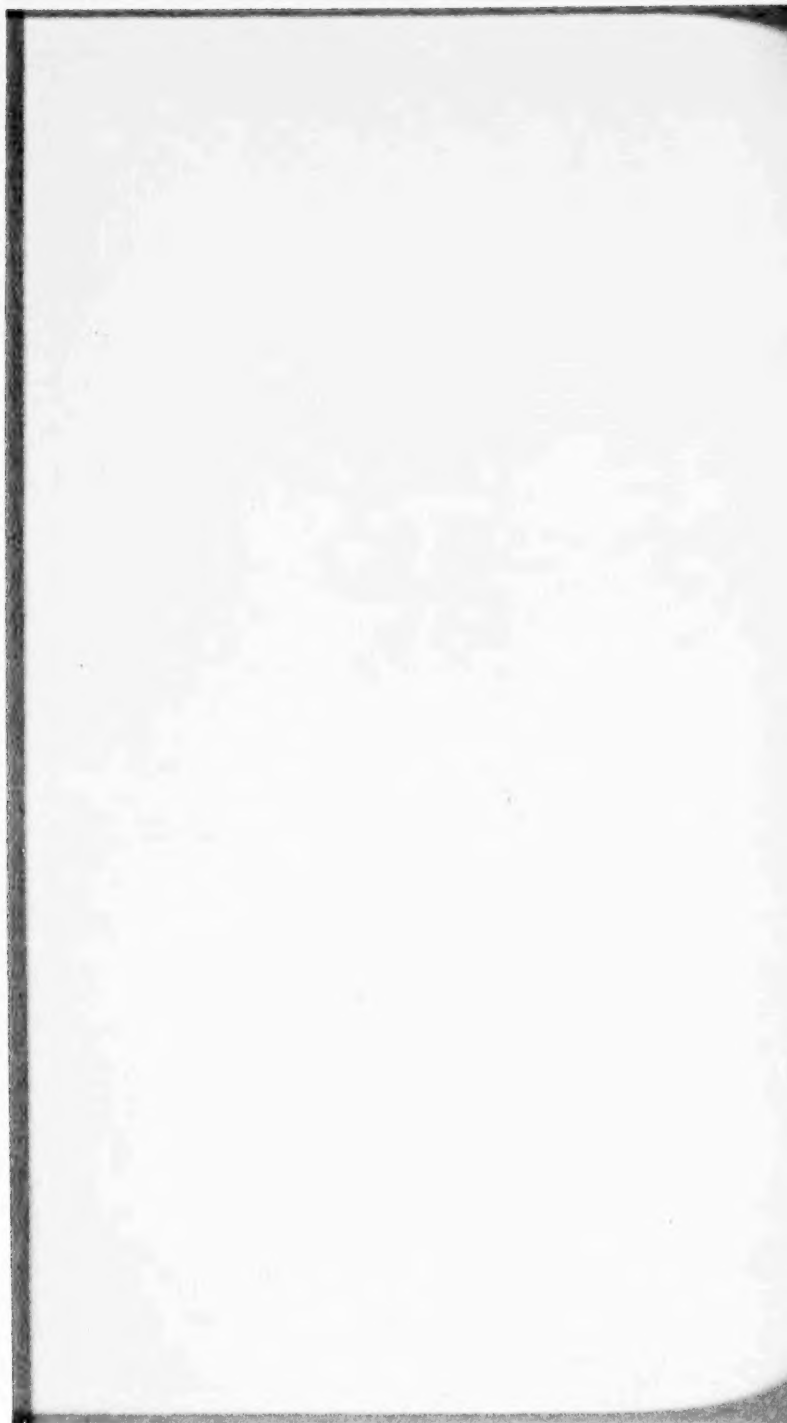
**AS PRESCRIBED BY THE**  
**INTERSTATE COMMERCE**  
**COMMISSION**

**IN ACCORDANCE WITH**  
**SECTION 20 OF THE ACT TO REGULATE**  
**COMMERCE**

— — —  
**THIRD REVISED ISSUE**  
— — —

**WASHINGTON**  
**GOVERNMENT PRINTING OFFICE**

**1911**



**CLASSIFICATION**  
**OF**  
**OPERATING EXPENSES**

AS PRESCRIBED BY THE  
**INTERSTATE COMMERCE**  
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IN ACCORDANCE WITH  
**SECTION 20 OF THE ACT TO REGULATE**  
**COMMERCE**

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**THIRD REVISED ISSUE**

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WASHINGTON  
GOVERNMENT PRINTING OFFICE

1911





## THE INTERSTATE COMMERCE COMMISSION.

---

Hon. MARTIN A. KNAPP, *of New York, Chairman.*

Hon. JUDSON C. CLEMENTS, *of Georgia.*

Hon. CHARLES A. PROUTY, *of Vermont.*

Hon. FRANCIS M. COCKRELL, *of Missouri.*

Hon. FRANKLIN K. LANE, *of California.*

Hon. EDGAR E. CLARK, *of Iowa.*

Hon. JAMES S. HARLAN, *of Illinois.*

EDWARD A. MOSELEY, *Secretary.*



At a General Session of the INTERSTATE COMMERCE  
COMMISSION, Held at its Office in Washington, D. C.,  
on the 3d Day of June, 1907.

*Present:*

Hon. MARTIN A. KNAPP, Chairman,	} Commissioners.
Hon. JUDSON C. CLEMENTS,	
Hon. CHARLES A. PROUTY,	
Hon. FRANCIS M. COCKRELL,	
Hon. FRANKLIN K. LANE,	
Hon. EDGAR E. CLARK,	
Hon. JAMES S. HARLAN,	

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

*It is ordered,* That the Classification of Operating Expenses and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form to be hereafter known as Third Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Division of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

*It is further ordered,* That the said Classification of Operating Expenses with the text pertaining thereto be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the act to regulate commerce as amended June 29, 1906,

in the keeping and recording of their operating expense accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all operating expense accounts in conformity therewith; and that a copy of such Third Revised Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

*It is further ordered,* That the rules contained in said Third Revised Issue of the Classification of Operating Expenses are, and by virtue of this order do become, the lawful rules according to which the said operating expenses are defined; and that each and every person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier is hereby required to see to, and under the law is responsible for, the correct application of the said rules in the keeping and recording of the operating expense accounts of any such carrier; and that it shall be unlawful for any such carrier or for any receiver or operating trustee of any such carrier or for any person directly in charge of the accounts of any such carrier or of any receiver or operating trustee of any such carrier to keep any account or record or memorandum of any operating expense item except in the manner and form in said Third Revised Issue set forth and hereby prescribed, and except as hereinafter authorized.

*It is further ordered,* That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in said Third Revised Issue established as may be required for the purposes of any such carrier or of any receiver or operating trustee of any such carrier; or may make assignment of the amount charged to any such primary account to operating divisions, to its individual lines, or to States: *Provided, however,* That a list of such subprimary accounts set up or such assignments made by any such carrier or by any

receiver or operating trustee of any such carrier be first filed in the office of the Division of Statistics and Accounts of this Commission subject to disapproval by the Commission.

*It is further ordered.* That in order that the basis of comparison between the fiscal year ending June 30, 1908, and previous years be not destroyed, any such carrier or any receiver or operating trustee of any such carrier may, during the twelve months ending June 30, 1908, keep and maintain, in addition to the operating expense accounts hereby prescribed, such portion or portions of its present accounts with respect to operating expense items as may be deemed desirable by any such carrier, or by ~~any~~ receiver or operating trustee thereof, for the purposes of such comparison; or, during the same period, may maintain such groupings of the primary accounts hereby prescribed as may be desired for that purpose.

*It is further ordered.* That any such carrier or any receiver or operating trustee of any such carrier may, in addition to the operating expense accounts hereby prescribed, keep any temporary or experimental accounts the purpose of which is to develop the efficiency of operations; *Provided, however,* That such temporary or experimental accounts shall not impair the integrity of any general or primary account hereby prescribed; and that any such temporary or experimental accounts shall be open to inspection by the Commission.

*It is further ordered.* That July 1, 1907, be, and is hereby, fixed as the date on which said Third Revised Issue shall become effective.

EDW. A. MOSELEY,

*Secretary.*

A true copy:

EDW. A. MOSELEY,

*Secretary.*

[L. S.]



## INTRODUCTORY LETTER.

INTERSTATE COMMERCE COMMISSION,  
DIVISION OF STATISTICS AND ACCOUNTS,  
*Washington, June 7, 1907.*

### TO CARRIERS:

The first revised issue of the Classification of Operating Expenses took effect July 1, 1894, and the second revised issue became effective July 1, 1901. The Classification herewith submitted will become effective July 1, 1907, and is issued in accordance with an order of the Interstate Commerce Commission, a copy of which will be found immediately preceding this letter.

It is eminently appropriate that public acknowledgment should be made to the Association of American Railway Accounting Officers, and to the standing and special committees appointed by that association, for their hearty cooperation in working out the details of this Classification. In no other way would it have been possible for the Commission to avail itself of that special knowledge and expert experience necessary for the successful accomplishment of the task undertaken. With one exception, the Classification of Operating Expenses herewith promulgated conforms to the recommendations of that association. This exception refers to the treatment of per diem and mileage payments between carriers on interchanged or loaned equipment, and, in view of the great variety of opinions expressed by railway accounting officers, as well as by certified accountants and others, relative to this point, it seems proper to submit an explanation of the reasons for the rules here promulgated. Be-

fore submitting that explanation, however, it may be proper to say a word relative to a new feature of this Classification, namely, the establishment of formal depreciation charges.

#### CONSIDERATION OF DEPRECIATION:

A number of points have been raised by correspondents relative to depreciation that call for the following general statements, all of which bear upon the manner in which depreciation accounts should be treated:

1. The question of depreciation is fundamentally a question of values, and not a question of maintaining the original capacity, or a standard of operating efficiency, or of keeping full the numbers in equipment series.

2. The depreciation rules may be worked either on the basis of the value of individual cars and locomotives, or on the basis of the value of series of cars and locomotives. On this point, accounting officers are at liberty, until advised to the contrary, to follow whichever method seems to them the more appropriate.

3. The basis of accumulation—that is to say, the amount to which the percentage rate is applied—ought, in strict theory, to be the original cost. For the current year, however, accounting officers are at liberty to accept original cost (estimated, if not known), record value, or purchase price. The term “record value” should not be interpreted to mean the value of the equipment as it stands in the capital account (unless that account represents the original value of the equipment on hand), but the actual cost or value of all equipment, regardless of where charged when purchased; and in case purchase price be accepted as the basis of the percentage charge to depreciation, the percentage rate should be limited to the rate required to replace the price paid. A second-hand locomotive, for example, is not called upon to provide for its replacement, when abandoned, by a new locomotive.



As stated above, it is values and not locomotives with which depreciation charges deal.

4. The application of depreciation charges for the current year and subsequent years must not be influenced by the practice of years past. In case property has been appreciated by excessive charges to operating expenses in years past, the value thus placed in the property must be regarded as a permanent undivided asset to the stockholders. On the other hand, in case property has depreciated on account of insufficient charges to operating expenses in years past, this fact must not be permitted to influence the determination of the depreciation rate for the current year.

5. The monthly charges to operating expenses for "depreciation" on the several classes of equipment, will, of necessity, create or require corresponding liability accounts to which such depreciation may be credited. To that end, carriers will be required, beginning July 1, 1907, to set up an appropriate liability depreciation account for each of the several classes of equipment upon which depreciation is charged. These accounts should be designated as follows:

- (a) Locomotives—Replacement;<sup>a</sup>
- (b) Passenger-Train Cars—Replacement;
- (c) Freight-Train Cars—Replacement;
- (d) Electric Equipment of Cars—Replacement;
- (e) Floating Equipment—Replacement;
- (f) Work Equipment—Replacement.<sup>b</sup>

To these replacement accounts should be credited monthly the amount of accrued depreciation on each class of equipment, respectively. Such credits should invariably equal the gross charges to maintenance for depreciation.

---

<sup>a</sup> Including both steam and electric.

<sup>b</sup> Except locomotives.

To these several replacement accounts under their appropriate heads should be charged, at cost, all equipment purchased, built, or otherwise acquired for the purpose of maintaining the value of a carrier's equipment.

The monthly charges to operating expenses for "renewals" of the several classes of equipment will be similarly treated.

It is not intended that these accounts should be restricted to individual cars or locomotives, or that carriers are not at liberty to renew or replace equipment upon which depreciation has accrued prior to the retirement of such equipment. On the other hand, the several amounts standing to the credit of those replacement accounts should be available to carriers for the purpose of replacement of equipment to the extent of such credits; however, all replacements in excess of such credits must be considered as Betterments or Additions, and charged either to Income or to Capital.

#### PER DIEM AND MILEAGE PAYMENTS BETWEEN CARRIERS:

In the second revised issue of the Classification of Operating Expenses, "Car mileage—balance" and "Hire of equipment—balance" were charged directly to operating expenses under the general account "Conducting Transportation." The propriety of including such items in operating expense accounts has been questioned by many railway accountants, it being claimed that the amount paid by one carrier for the use of cars and locomotives of another carrier is in its nature a rental and not an operating expense.

This suggestion, that the per diem and mileage for cars, for example, should be treated as a rental proposition, while in the main correct, involves a result which from the statistical point of view can not be wholly approved.

for the reason that under the regulations for depreciation operating expenses are charged with the depreciation upon the total equipment of the carrier, while, as a matter of fact, some or all of that equipment may at some time or other during the year be in operation on the line of another carrier. Such a method of treating per diem and mileage payments would burden the general account "Maintenance of Equipment" of a lessor road with an expense not traceable to the traffic of the lessor road. From the statistical point of view, operating expenses are a measure of the cost of transportation, and no expense should be included in the operating accounts of one carrier that is occasioned by the traffic of another carrier, from which it follows that the Maintenance of Equipment accounts of a lessor road should not be burdened with Repairs, Renewals, or Depreciation occasioned by the use of its cars by a lessee road, for not only would this make the account in question too high when assigned to the traffic of an individual carrier, but it would destroy comparison between the Maintenance of Equipment accounts of lessor and of lessee roads.

A complete analysis of the situation discloses the fact that the gross rental charge is in part an operating expense and in part a rent proper, and the Classification herewith promulgated provides for the separation of the gross rental charge accordingly.

To that end it is held that while the operating expenses of a carrier should include charges on account of

- (a) Repairs incident to operation,
- (b) Premature retirement of equipment, and
- (c) A proper depreciation on equipment,

they should also include, under an appropriate account, a proper charge for wear and tear of another company's equipment while in use on the lines of the carrier company. At the same time the carrier's operating expenses

should receive credit through an appropriate account for a proper proportion of wear and tear on its equipment while in service on the lines of other companies, and these debits and credits should be made against the rents paid and received for the use of such equipment.

The chief difficulty in arriving at an accurate measure of wear and tear of equipment under the foregoing conditions arises from the fact that shop accounts do not readily furnish the necessary information for an accurate division. Until a more accurate measure of this class of repairs can be determined from the experience of carriers, it is necessary to lay down an arbitrary rule for that measure, and, for the current year, in the case of freight cars interchanged, 12 cents per car per day will be charged and credited to operating expenses under "Maintenance of Equipment," and the remainder of the rental charge will be carried to the income account through an appropriate clearing account as representing approximately the measure of net rental paid or received.

To the end that the payments made and the revenue earned on account of interchanged equipment may be properly taken care of through the income account, and that operating expenses may finally include a proper proportion of the wear and tear on equipment owned by other carriers, companies, or individuals, and used upon the line of a particular carrier, from July 1, 1907, carriers will be required to open a clearing account, to be designated as—

#### CLEARING ACCOUNT—HIRE OF EQUIPMENT.

To this account should be charged monthly:

- (1) The gross accruals for the use of equipment of all classes belonging to another carrier or company on a basis of Per Diem, Mileage, or Rental.

To it should be credited monthly:

- (2) The gross accruals for the use of a carrier's equipment while on the lines of other carriers, companies, or individuals ("car service" excepted), either on a basis of Per Diem, Mileage, or Rental.

To it should also be charged monthly:

- (3a) An amount equal to 12 cents per car per day for the number of car-days a carrier's freight-train cars are on the lines of other carriers or in use by other companies or individuals.
- (3b) A percentage proportion of the depreciation charge for each class of equipment other than freight-train cars, based upon the equipment-days a carrier's equipment of that class is on the lines of other carriers or in use by other companies or individuals.

NOTE.—These two debits should invariably equal the monthly credit to Maintenance of Equipment under the primary account "Equipment Loaned—Cr."

To it should also be credited monthly:

- (4) An amount equal to 12 cents per car per day for the number of car-days freight-train cars of other carriers, companies, or individuals are on the line of the carrier company.<sup>a</sup>

NOTE.—This credit should invariably equal the debit to Maintenance of Equipment under the primary account "Equipment Borrowed—Dr."

This account should be balanced at the close of each fiscal year, or periodically, at the option of the carrier, and the balance thereof carried as a debit or a credit,

<sup>a</sup> Compare Accounting Series Circular No. 14, issued under date of July 30, 1907, which provides for a credit entry corresponding to the debit charge "(3b)."

as the case may be, to Income Account as "Hire of Equipment."

Attention is called to the fact that by means of the adjustment of per diem and mileage payments between carriers herewith prescribed, operating expenses are made to serve the double purpose of disclosing the true measure of the cost of traffic, notwithstanding the fact that one road owns more and another road owns fewer cars than it operates, and, further, of disclosing the full cost of maintaining equipment, whether such equipment is used by its owner or by another carrier.

To the end that uniformity of operating accounts may be maintained from year to year, carriers will be required to submit all questions of doubtful interpretation to this office for consideration and decision.

HENRY C. ADAMS,

*In charge of Statistics and Accounts.*

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## TEXT OF CLASSIFICATION OF OPERATING EXPENSES.

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### I. MAINTENANCE OF WAY AND STRUCTURES.

#### SUPERINTENDENCE.

This account includes:

**PAY OF OFFICERS.**—Pay of vice-president or assistant when directly in charge of maintenance of way and structures, chief engineer, assistant chief engineer, chief engineer maintenance of way, engineer maintenance of way, assistant engineer maintenance of way, engineer of bridges and buildings, principal assistant engineer, engineer right of way, architect, division engineer, assistant engineer, assistant division engineer, roadmaster, assistant roadmaster, master carpenter, assistant master carpenter, supervisor, assistant supervisor, fire and sanitary inspector, and other officials engaged in the maintenance-of-way-and-structures department.

**PAY OF CLERKS AND ATTENDANTS.**—Pay of chief and other clerks, draftsmen, rodmen, transitmen, and chainmen, and attendants in offices and on special cars of officers whose pay is charged to this account.

**OFFICE AND OTHER EXPENSES.**—Rent and cost of repairing rented offices, rent and cost of telephone service, telegraph messages, heat, light, ice, water, furniture, and supplies for offices of officers whose pay is charged to this account; incidental office and traveling expenses of such officers and their clerks; cost of provisions for and expenses of special cars when used by them, and cost of running special trains for officials mentioned; premiums on fidelity bonds of such officers and their assistants; expenses of photographing buildings and structures.

Cost of drafting and engineering instruments and expenses of repairing same and cost of supplies (except stationery and printing) used by officers and employees whose pay is charged to this account.

The following is a list of the more important articles chargeable to this account.

Atlases,	Levels,	Slide rules,
Barometers,	Magnets,	Stakes,
Books, scientific and reference,	Magnifiers,	Straightedges,
Boxes for blueprints,	Oilstones,	Tacks for drawing boards,
Boxes for drawing instruments,	Pantographs,	Tally registers,
Cameras, and supplies for,	Parallel rulers,	Tapelines,
Chains,	Periodicals,	Tee squares,
Compasses,	Plane tables,	Telescopes,
Curves,	Planimeters,	Thermometers,
Directories,	Plummets,	Tin boxes for tracing and printing,
Drawing boards,	Protractors,	Transits,
Drawing instruments,	Ranging poles,	Traverse tables,
Field glasses,	Reading glasses,	Triangles,
Keel,	Rods,	Tripods,
Level rods,	Seals,	Verniers,
	Section liners,	
	Sextants,	

NOTE A.—When employees enumerated above are engaged in work not chargeable to "Maintenance of Way and Structures" their pay and expenses should be charged to the specific work on which engaged.

NOTE B.—When officers and others above enumerated have supervision over other departments also, their salaries and expenses should be apportioned equally between the departments over which they have jurisdiction.

## BALLAST

This account includes all expenses incident to the purchase and production of ballast, as follows: Purchase price of gravel, stone, slag, cinders, sand, and other material used for ballast, including freight charges, if any, and cost of first unloading; payments for gravel and quarry rights and privileges; expenses of sinking test holes; expenses of locomotives and work trains while engaged in delivering ballast at points where used.

When a gravel pit or quarry is to be opened, the operations of which are likely to extend over a long period, an account should be opened designated "Operations of Gravel Pit at \_\_\_\_\_," or "Operations of Quarry at \_\_\_\_\_," as the case may be.

To such account should be charged:

(a) The excess cost of the land over its estimated value after the gravel or stone has been removed. (Such

estimated value being charged to an appropriate capital account.)

- (b) The expenses for clearing, stripping, draining, and ditching the land, and of moving and changing fences and buildings preparatory to opening.
- (c) The cost of rails and fastenings, in excess of their estimated scrap value, used in constructing tracks to and in the gravel pit or quarry. (Such estimated scrap value to be carried in an appropriate material account.)
- (d) The total cost of ties and other material and of labor expended on such tracks.
- (e) Cost of labor and train service (see account "Roadway and Track") employed in producing, quarrying, and loading ballast, including operations of stationary engines, steam shovels, stone crushers, etc., and watchmen.
- (f) Repairs of stationary engines, steam shovels, stone crushers, and other similar machinery used in producing ballast.
- (g) Depreciation of machinery permanently used in gravel pits and quarries.
- (h) Cost of explosives, hand tools, and miscellaneous expenses.

This "Operations of Gravel Pit" or "Operations of Quarry" account should be credited from month to month with the number of cubic yards used on the basis of the average cost of production, and account "Ballast" or other proper account charged. The average cost of production should be determined by dividing the total charge to the account of any pit or quarry by the estimated number of cubic yards it contains.

As stripping and other preparatory expenses are not always incurred in full before beginning to take out the gravel or stone, the cost of production should include an estimate of the total of such expenses.

NOTE A.—The cost of loading chders at ash pits should be charged to account "Enginehouse Expenses—Yard" or account "Enginehouse expenses—Road."

NOTE B.—The cost of labor putting ballast into track should be charged to account "Roadway and Track."

## TIES.

This account includes cost (including inspection) of cross, switch, and bridge ties, head blocks and railway crossing timbers (plain or treated) for main and repair tracks, sidings, and spurs; in tunnels, stations, shop and other yards, on piers, wharves, track scales, inclines, bridges, trestles, and culverts; to coal chutes, coal pockets, and incline and water stations (except on inclines to and in fuel stations); on tracks in ballast pits, enginehouses, shops, and storehouses, and on transfer tables and turntables).

NOTE A. The cost of labor unloading, distributing, and putting ties in track and the expenses of trains distributing ties should be charged to account "Roadway and Track."

NOTE B. This account may include each month a proportion of the total amount authorized or approximated for renewals during the fiscal year regardless of the month in which the actual renewal is made.

## RAILS.

This account includes cost (including inspection) of rails for main and repair tracks, sidings, and spurs; in tunnels, stations, shop and other yards on piers, wharves, track scales, inclines, bridges, trestles, and culverts; in tracks to coal chutes, coal pockets, and incline and water stations (except on inclines to and in fuel stations); on tracks in ballast pits, enginehouses, shops, and storehouses, and on transfer tables, turntables, and car floats), less the value of old rails taken up.

NOTE A. The cost of labor unloading, distributing, and laying rails in track, and the expenses of trains picking up and loading rails taken out of track should be charged to account "Roadway and Track."

NOTE B. This account may include each month a proportion of the total amount authorized or approximated for renewals during the fiscal year, regardless of the month in which the actual renewal is made.

## OTHER TRACK MATERIAL.

This account includes cost of all track material not chargeable to ballast, ties, and rails; also expenses of repairing track appliances.

The following is a list of the more important articles chargeable to this account:

Anticreepers,	Nut locks,	Switch lamps,
Angle bars,	Nuts,	Switch locks and keys,
Connecting rods,	Offset bars,	Switch points,
Derails,	Rail braces,	Switches,
Frog and guard rail blocking,	Rail chairs,	Switch-stand bolts,
Frogs,	Rail joints,	Targets, switch,
Guard rails (except on bridges and trestles),	Splice bars,	Tie plates,
Guard rail clamps,	Stands, switch,	Tie plugs,
Guard rail fasteners,	Step chairs,	Tie rods,
Main rods,	Switch chairs,	Track bolts,
	Switch crossings, rigid or ship,	Track spikes.

## ROADWAY AND TRACK

This account includes:

**APPLYING BALLAST.** Pay of employees engaged in preparing roadbed for the reception of ballast; also pay of employees engaged in applying ballast after it has been prepared and unloaded.

**APPLYING TIES.**—Pay of employees engaged in unloading, distributing, and renewing cross, switch, and bridge ties, head blocks and railway crossing timbers, respacing ties, and burning old ties.

**APPLYING RAILS.**—Pay of employees engaged in unloading, distributing, cutting, slotting, drilling, and laying rails, adzing for new rails, gathering and loading old rails, and adjusting expansion and contraction.

**APPLYING OTHER TRACK MATERIAL.**—Pay of employees engaged in applying rail braces, angle bars, rail joints, track bolts and spikes, nut locks, anticreepers, switches, switch stands, frogs, crossing frogs, tie plates, tie plugs, and other miscellaneous track material not specified above.

**TRACK MAINTENANCE.** Pay of employees engaged in alining, surfacing and gaging tracks, placing and removing track shims and tightening bolts and spikes in tracks. When a track is taken up, the labor expended therefor should be charged to this account, whether another track is laid to replace it or not.

**CARE OF ROADBED.**—Expenses of constructing and cleaning tile and open ditches; cost and expenses of placing and cleaning sewer pipes for drains (cost of sewer pipes laid under tracks should be charged to account "Bridges, Trestles, and

Culverts"); cost of material used and labor expended in sloping cuts, blasting rock, widening roadbeds, cuts, fills, and embankments, filling borrow pits, removing slides, dangerous rocks, and other similar obstructions; expenses of operating steam shovels, scrapers, and ditchers while engaged in such work; also expenses of keeping tracks clear and repairing the subgrade of tracks in cases of freshets or washouts and cost of boarding employees so engaged. Cost of labor building temporary tracks around slides and washouts and removing such tracks; cost of replacing rails, ties, and ballast and repairing other damages caused by washouts to tracks proper or to roadbed; cost of cutting, handling, and placing sod; also landscape gardening and beautifying along roadway (except when chargeable to account "Buildings, Fixtures, and Grounds").

GENERAL CLEANING.—Pay of employees engaged in mowing right of way and burning grass and weeds; cost of operating weed burners, removing brush, grass, and drift from right of way, and removing cinders dumped by passing trains, plowing fire guards, removing weeds from and dressing ballast, cutting sod lines, removing dirt from track yards, cleaning streets used as roadways, and loading and handling track scrap.

PATROLLING AND WATCHING.—Pay of track walkers, track watchmen, patrolmen, employees while extinguishing fires on right of way and adjacent property, and watchmen at bad spots in tracks, slides, and dangerous places. (For pay of bridge watchmen see account "Bridges, Trestles, and Culverts," for pay of street crossing watchmen see account "Crossing Flagmen and Gatemen," and for pay of tunnel watchmen see account "Tunnels.")

CHANGING ALINEMENT AND GRADES.—The proportion chargeable to operating expenses of cost of material used and labor expended in changing the alignment and reducing grades.

BANK PROTECTION.—Cost of material used and labor expended in protecting banks by retaining walls, riprap, piling, piers, dikes, or other means, and in constructing breakwaters and revetments, and diverting the channels of streams to prevent cutting, washing, or sliding of embankments.

FILLING.—Cost of material used and labor expended in filling bridges, trestles, culverts, and cattle pits.

OTHER EXPENSES.—Cost of material used and labor expended in paving and improving streets used as roadway, and



oiling roadbed; payments of assessments for street repairs, sewers, or other public improvements affecting roadway adjacent thereto, not chargeable to account "Buildings, Fixtures, and Grounds;" expenses incident to track inspection, premiums in connection therewith, and any other roadway or track expenses not provided for elsewhere.

**TRAIN SERVICE.**—Pay of work-train enginemen, trainmen, and enginehousemen; cost of fuel, stores, and other supplies for work-train locomotives and cars; cost of oil and wicking used in lanterns of work-train enginemen and trainmen, while such employees and equipment are engaged in work pertaining to roadway and track.

#### REMOVAL OF SNOW, SAND, AND ICE.

This account includes the cost of removing snow, sand, and ice from tracks; pay of work-train enginemen, trainmen, and enginehousemen; cost of fuel, stores, and other supplies for work-train locomotives and cars; cost of oil and wicking used in lanterns of work-train enginemen and trainmen while such employees and equipment are engaged in clearing tracks and hauling snow; wages paid men employed in shoveling snow and picking ice on tracks, and tools specially furnished them for this purpose, and their meals; fuel and stores used by rotary and other snowplows and other snow and ice clearing appliances and wages of men employed in operating them; cost of repairing snowplows (other than snowplow cars which are covered by account "Work Equipment—Repairs,") and flangers and the cost of putting them on and removing them from locomotives and cars, and cost of slatting pilots. Wages paid engineers, firemen, and trainmen held in readiness to go out with snowplows; payments for use of land on which to place snow fences, and for salt for keeping switches free from ice and snow. Cost of distributing and setting up portable snow fences and gathering them up and loading, hauling, and piling them along the road. (For repairs, see account "Snow and Sand Fences and Snow Sheds.")

#### TUNNELS.

This account includes cost of repairing tunnels, including the cost of timber and other material, false work, and special tools; pay of tunnel watchmen and cost of supplies used by them; repainting and whitewashing; oil and wicks, and repairs of lamps, lanterns, and electric-light fixtures used in

lighting. This account does not include renewals or repairs to roadway or tracks through tunnels.

#### BRIDGES, TRESTLES, AND CULVERTS.

This account includes cost of material used (less salvage) and labor expended in repairing and renewing bridges, trestles, culverts (both substructure and superstructure), piers, abutments, masonry, and drainpipes, including repairs made necessary by washouts; retaining walls, riprapping, and dikes necessary to protect or strengthen bridges and culverts against ice, water, or drift; guards on bridges, framing ties for bridges; bridge signs or number boards; expenses of operating and rent of pile drivers and other equipment engaged in repairing and renewing bridges and culverts; cost of cleaning channels under bridges and cleaning culverts; gravel decking for protection against fire, and altering and bracing bridges and trestles during progress of filling.

Cost of removing old bridges in connection with construction of new bridges, and constructing and removing temporary or false work used in repairing and renewing bridges and culverts.

Pay of bridge foremen and bridge watchmen, except in drawbridges, and cost of all supplies used by them, such as brooms, lanterns, oil, oil cans, pails, rowboats, tallow, waste, and water barrels, and fuel for heating bridge watchhouses; also repairs to and renewals of stationary engines at drawbridges.

Pay of bridge inspectors and expenses incident to bridge inspection.

Pay of work-train enginemen, trainmen, and enginehouse-men, and of employees engaged in operating pile drivers; cost of fuel, stores, and other supplies for work-train locomotives and cars and of oil and wicking used in lanterns of work-train enginemen and trainmen while such employees and equipment are engaged on work pertaining to bridges and culverts.

NOTE A. Any structure carrying the tracks over other tracks, a stream, highway, or canal should be considered a bridge or a culvert. The cost of maintaining structures carrying other tracks, canals, highways, etc., over a carrier's tracks should be charged to account "Over and Under Grade Crossings."

NOTE B. This account may include each month a proportion of the total amount authorized or approximated for renewals

during the fiscal year regardless of the month in which the actual renewal is made.

NOTE C. Insurance recovered on bridges, trestles, and culverts should be credited to this account.

## OVER AND UNDER GRADE CROSSINGS.

This account includes cost of material used (less salvage) and labor expended in repairing and renewing overhead bridges and viaducts of all kinds (except station overhead footbridges not public highways), log chutes and rollways erected over the tracks of a carrier, and roadways of under-grade crossings, foot or wagon (except subways not public highways); cost of drainage and excavations for undergrade crossings; expenses of opening public roads for purposes of eliminating grade crossings.

## GRADE CROSSINGS, FENCES, CATTLE GUARDS, AND SIGNS.

This account includes:

**HIGHWAY GRADE CROSSINGS.**—Cost of material used (less salvage) and labor expended in repairing and renewing street and road (including farm) crossings at grade, crossing drains, crossing gates, crossing signal bells, and batteries with track instruments and connections; and warning signals; cost of water pipes, water and hose for sprinkling grade crossings; and payments of assessments for street repairs or sewers at crossings. (Street repairs or sewers within the limits of shop grounds or immediately adjacent to station buildings should be charged to account "Buildings, Fixtures, and Grounds.")

**FENCES AND CATTLE GUARDS.**—Cost of material used (less salvage) and labor expended in repairing and renewing right-of-way fences, cattle guards, wing fences, aprons, and hedges.

**SIGNS.**—Cost of yard-limit signs; subdivision boards; mile, section, whistle, water station, water trough, slow, stop, and boundary posts; overhead bridge and tunnel cautions; monument stones, and all other roadway signs.

NOTE.—The cost of station and telegraph signs, fences, and hedges around building sites and shop grounds, and of paving sidewalks, streets, and driveways within the limits of or immediately adjacent thereto, should be charged to account "Buildings, Fixtures, and Grounds."

## SNOW AND SAND FENCES AND SNOWSHEDS.

This account includes all expenses of repairing, renewing, and replacing permanent and portable snow and sand fences

(except when the permanent fence takes the place of right-of-way fence, in which case the expense should be charged to the account "Grade Crossings, Fences, Cattle Guards, and Signs"), snowsheds, including necessary rock filling, and cost of protecting from fire; pay of snowshed watchmen and cost of supplies used by them, cost of planting and caring for trees to protect track from snow.

*NOTE.*—The cost of distributing and setting up portable snow fence panels, and gathering, loading, hauling, unloading, and piling should be charged to account "Removal of Snow, Sand, and Ice."

### SIGNALS AND INTERLOCKING PLANTS.

This account includes:

**INTERLOCKING PLANTS.**—Cost of material used (less salvage) and labor expended in repairing and renewing the buildings and all appliances of interlocking plants, power interlocking plants, and all machinery such as air compressors, levers, boilers, dynamos, engines, and machinery and fixtures used in connection therewith.

**SIGNALS.**—Cost of material used (less salvage) and labor expended in repairing and renewing block, automatic, and semiautomatic signals.

**OTHER EXPENSES.**—Cost of material used (less salvage) and labor expended in repairing and renewing home and distant signals, signal posts, signal bridges, semaphores, train-order signals or order boards, and flag-station signals, gates at crossings of other railways, and all other road or track signals not provided for above, used in the government of the movement of trains, including signal lamps and their connections. Pay of signal engineers and supervisors of signals and their assistants, their office and traveling expenses; also pay of mechanics and laborers and cost of special tools while engaged in repairing and renewing interlocking plants and signals.

*NOTE.*—This account does not include the cost of maintaining and renewing track material proper required in connection with interlockers, such as switches, special track fastenings, split rails, frogs, etc., which costs should be charged to account "Other Track Material."

### TELEGRAPH AND TELEPHONE LINES.

This account includes:

**TELEGRAPH.**—Cost of material used (less salvage) and labor expended in repairing and renewing telegraph lines owned by

a carrier, or for which it is responsible; also cost of conduits, poles, cross-arms, wire, insulators, cables, cable boxes, instruments, battery jars, switchboards, and all other appurtenances forming a part of the plant. Pay of chief line repairmen, linemen, and other employees, and cost of special tools used by them; also pay, office and traveling expenses of superintendent and assistant superintendent of telegraph, their clerks and attendants.

**TELEPHONE.** All expenses similar to the above, incurred in connection with telephone lines, and telephone boxes on telegraph and telephone poles.

Pay of work-train enginemen, trainmen, and enginehouse-men, and other employees, cost of fuel, stores, and other supplies for work-train locomotives and cars and of oil and wicking used in lanterns of work-train enginemen and trainmen, while such employees and equipment are engaged on work pertaining to telegraph and telephone lines.

**NOTE.** The salaries and expenses of superintendents and assistant superintendents of telegraph and their clerks when engaged in both maintaining and operating telegraph and telephone lines should be charged 50 per cent to account "Telegraph and Telephone Lines" and 50 per cent to account "Telegraph and Telephone Operation."

## **ELECTRIC POWER TRANSMISSION.**

This account includes cost of material used (less salvage) and labor expended in repairing and renewing all appliances for transmitting power from power houses and substations to the place where it is to be applied; covers span, guard, feed, and overhead trolley wires, poles, cross-arms, brackets, insulators and connections, third rail, including braces, supports, and devices for insulating, covering, or protecting; bonding rails, including connecting plugs, insulating mats, plugs, or other devices; switchboards, switches, cut-outs, transformers, etc. (except at power and substations); pay of electricians, mechanics, and other employees engaged in repairing and renewing electric power transmission lines; also pay of work-train motormen, enginemen, trainmen, and enginehousemen and other employees, and cost of fuel, electric current, stores, and other supplies for work-train locomotives and cars, and of oil and wicking used in lanterns of work-train enginemen and trainmen while such employees and equipment are engaged on work pertaining to electric power transmission lines.

## BUILDINGS, FIXTURES, AND GROUNDS.

This account includes all expenses incident to repairing and renewing buildings owned by a carrier and used in its operations (not otherwise provided for herein) and maintaining driveways and grounds connected therewith, as follows:

**BUILDINGS.**—Cost of material used (less salvage) and labor expended in repairing and renewing buildings and platforms; also station subways and station overhead footbridges not public highways and stairways for approaches to stations; and in painting, glazing, graining, varnishing, papering, cal-cimining, and decorating buildings; signs on buildings; building permits; cost of land for buildings when chargeable to expenses; removing old structures, and removing snow from roofs of buildings.

The following is a list of the more important structures classified as buildings:

Air-compressing houses,	Grain elevators,	Sand houses,
Baggage rooms,	Grain warehouses,	Scrap bins,
Bins for material,	Greenhouses,	Section houses, dwelling,
Boarding houses,	Hand-car houses,	Shops, blacksmith,
Breakwaters for protec-	Hay houses,	Shops, car,
tion of buildings,	Hose houses,	Shops, machine,
Buildings and rooms for	Houses for oil and lan-	Stables,
trainmen,	terns used by train-	Station platforms,
Buildings on piers,	men,	Station signs,
Carpenter shops,	Ice houses,	Station subways,
Car sheds,	Laboratories,	Station stairways,
Coal chutes,	Lumber sheds,	Stations, freight,
Coal chute, enginehouse,	Mail cranes,	Stations, passenger,
Coal chute, inclines (in-	Milk stands,	Stock pens,
cluding tracks thereon),	Offices,	Storehouses,
Coal hoists,	Offices, general,	Switch-tender houses,
Coaling platforms,	Oil houses,	Tanks, gas,
Dry houses,	Outhouses,	Tanks, oil,
Dwellings,	Planing mills,	Tanks, water,
Eating houses,	Platforms, passenger,	Telegraph offices,
Elevators,	Platforms, freight,	Test rooms,
Enginehouses,	Power houses,	Tool houses,
Express buildings,	Power houses for electric	Track scales,
Fire-engine houses,	traction lines,	Transfer houses,
Foundries,	Pump houses,	Waiting rooms,
Fuel houses or stations,	Reaving rooms,	Warehouses,
Gas-compressing houses,	Repair shops,	Wash rooms,
General offices,	Rooms for Y. M. C. A.,	Watchhouses,
Grain cribs,	Roundhouses,	Water stations.

**FIXTURES.**—Cost of fixtures (less salvage), such as bunks, counters, file cases, ice chests, railings, shelving, washbowls, water coolers, etc., when immovable and built in as a part of the structure; also cost of repairing and renewing such fixtures.

**MACHINERY.**—Cost of material used (less salvage) and labor expended in repairing and renewing machinery and structures (except tools and machinery chargeable to accounts "Signals and Interlocking Plants," "Shop Machinery and Tools," and "Power Plant Equipment") used in connection with buildings, such as air compressors, armatures and fields, ash buckets, ash hoists, belting, boilers, chutes, cisterns, coal buckets, coal huggies, coal pockets, cranes, derricks, dump cars for fuel plants, dynamos and parts, fire engines, fire extinguishers, fire hose, gas pumps, hoists, hose carts, hose reels, hydrants, hydraulic rams, pipe lines, pumps, sand driers, scales for weighing fuel, screens, shafting, standpipes, stationary engines, steam pipes, switchboards and parts (except telegraph and telephone), tipples, track tanks, trestles, water troughs, windmills, and wood racks.

**OTHER EXPENSES.**—Cost of material used (less salvage) in repairing and renewing transfer tables and turntables, including tracks thereon, cinder pits, drop pits, tracks in engine-houses, shops, and storehouses and on inclines of fuel stations, framework for shunting, foundations for machinery, and stationary scales of all kinds, including foundations, platforms, supports for dead rails, beams, weights, and all fixtures and appurtenances; also the cost of draining scale pits and testing and inspecting scales; expense of protecting pipes, and of drilling, testing, and prospecting for water supply, and payments for permanent water rights.

Cost of material used (less salvage) and labor expended in repairing and renewing stationary fixtures used in connection with heating and lighting buildings; such as arc lamps, chandeliers, electric-light fixtures, electric-light wiring, electroliers, furnaces, gas burners, box lamps at stations, lamps when permanently attached to buildings, pipes, radiators, and registers.

Cost of repairing and renewing stationary fixtures used for supplying buildings with water, or for draining; water pipes, water-closets, and washstands; freight and passenger

elevators; piping, hydrants, and other permanent fixtures for cleaning, heating, and lighting cars; ore and coal conveyors, cleaning sewers, framing cross-ties for water troughs, protection against fire, such as water mains and fire plugs; also protecting buildings and grounds against floods and washouts by means of walls and embankments.

**GROUND.**—Cost of material used (less salvage) and labor expended in repairing and renewing fences, hedges, walls, sidewalks, and streets within the limits of shop grounds, or immediately adjacent to buildings, not provided for elsewhere; fences between tracks at stations; and driveways and alleys used for receipt or delivery of passengers or freight at stations or in yards; dams, ponds, reservoirs, and wells. Payments of assessments for street repairs, sewers, or other public improvements affecting building sites and shop grounds. Cost of laying out, cleaning (except ordinary cleaning performed by station cleaners), grading, draining, mowing, and beautifying shop and station grounds, and landscape gardening (including cost of plants at such grounds); also cost of trees and shrubs, and of maintaining and operating nurseries. Pay of subdivision foremen, work-train enginemen, trainmen, and enginehousemen, and of employees engaged in operating steam shovels, scrapers, pile drivers, and ditchers; cost of fuel, stores, and other supplies for work-train locomotives and cars, and oil and wicking used in lanterns of work-train enginemen and trainmen, while such employees and equipment are engaged on work pertaining to buildings and grounds.

**NOTE A.**—This account may include each month a proportion of the total amount authorized or approximated for renewals during the fiscal year regardless of the month in which actual renewal is made.

**NOTE B.**—Insurance recovered on buildings, fixtures, and grounds should be credited to this account.

**NOTE C.**—This account should not include costs of repairing and renewing buildings, fixtures, and grounds, the operations of which are included in "Outside operations."

## **DOCKS AND WHARVES.**

This account includes cost of material used (less salvage) and labor expended in repairing and renewing docks, wharves, piers, and other landings, ferry slips, transfer bridges, pontoons, slips, bulkheads, jetties, and inclines thereto, including filling, strengthening, bracing, and painting; expenses of op-



erating pile drivers, tugs, barges, and floats, while engaged on such work.

Cost of dredging about docks, piers, bulkheads, and ferry slips, or for approaches to such properties, and removing material dredged out; expenses of operating dredges, mud scows, barges, and floats, and pay of crews, divers, and pilots while engaged on such work; cost of crib work, racks, or caissons constructed for preserving the depth of water secured by dredging; cutting ice around docks and wharves to prevent damage; guard and other piling and protection from damage by drift or ice; also pay of supervisors of docks and wharves.

Pay of work-train enginemen, trainmen, and enginehouse-men, and of employees engaged in operating pile drivers, dredges, and tugboats; cost of fuel, stores, and other supplies for work-train locomotives and cars, and of oil and wicking used in lanterns of work-train enginemen and trainmen, while such employees and equipment are engaged on work pertaining to docks and wharves.

NOTE A.—Cost of maintenance of trucks and buildings on docks and wharves should be charged to other appropriate accounts herein provided.

NOTE B.—This account should not include costs of repairing and renewing docks and wharves the operations of which are included in "Outside Operations."

## ROADWAY TOOLS AND SUPPLIES.

This account includes cost of roadway tools when chargeable to expenses (except tools otherwise provided for) and cost of all material used (less salvage), and labor expended in repairing and renewing all tools, implements, flags, and lanterns used in repairing roadway, tracks, interlocking plants and signals, electric traction lines, fences, road crossings, signs, telegraph lines, bridges, culverts, buildings, and other structures.

Cost of oil, waste, or like material used on hand cars and hand trucks, oil and wicking used in lanterns of track walkers, track watchmen, or patrolmen; ice and oatmeal for drinking water of track repair men; and heating and lighting subdivision tool houses.

The following is a list of the more important roadway tools chargeable to this account:

Axes,	Handles, ax,	Saws, hand,
Axvils,	Handles, hatchet,	Scrap boxes,
Angers,	Handles, maul,	Seythes,
Axes,	Handles, pick,	Shovels,
Ballast forks,	Hatchets,	Shovels, coal,
Bars, claw,	Hoes,	Shovels, railroad,
Bars, crow,	Hydraulic outfit,	Sickles,
Bars, lining,	Jack levers,	Signal lanterns,
Bars, pinch,	Jacks, hydraulic,	Sledges,
Bars, rading,	Jacks, ratchet,	Spades,
Bars, tampling,	Jacks, screw,	Spike mauls,
Braces and bits,	Keys, water,	Spike pullers,
Brooms,	Lanterns and fixtures,	Spot boards,
Brush hooks,	Lawn mowers,	Squares,
Cables,	Levels,	Straightening machines,
Cable stretchers,	Lines for ditching,	Stone drills,
Cans, oil,	Lines, tape,	Switch ropes (when used in repairing roadway)
Cans, water,	Nippers,	Taplines,
Cant hooks,	Oilstoves,	Thermometers for laying rail,
Cars, hand,	Pailbuck,	Timber trucks,
Cars, lever,	Pails, water,	Tongs,
Cars, motor inspection,	Paint brushes,	Tool boxes,
Cars, push,	Picks, clay,	Torches,
Chairs,	Picks, tampling,	Track gages,
Chisels, track,	Pike poles,	Track jacks,
Curbing hooks,	Pile drivers, not on cars,	Track levels,
Dipper,	Plows,	Velocipedes,
Drawing knives,	Post-hole diggers,	Vies,
Drill bit,	Post-hole tampers,	Wood spuds,
Drills,	Punches,	Wheelbarrows,
Engines, hoisting,	Rail benders,	Whetstones,
Flags, signal,	Rail tongs,	Wood chisels,
Furnaces, portable,	Rail unloaders,	Wood mallets,
Grindstones,	Rakes,	Wrenches, monkey,
Hammers, napping,	Ratchet drills,	Wrenches, track,
Hammers, paving,	Rock crushers,	
Hammers, spiking,	Rope,	
Handles, adz,	Saws, crosscut,	

## WORK EQUIPMENT REPAIRS

This account includes cost of material used less salvage and labor expended in repairing, painting, and bettering work or service equipment of all classes (see "Note A" under this account), furniture for cabin or caboose cars, and fixtures for all work or service cars, including cost of re-equipment, such as bunks, coal boxes, coal hods, curtains, cushions, lamp fixtures, links and pins, screens, stoves, and fixtures; also

cost of repairing commercial cars and locomotives when assigned to and in maintenance-of-way service; changes made in such cars to fit them for work service, and refitting them for commercial service; cost of repairing floating equipment used in maintenance or construction of a carrier's property, such as floating pile drivers, dredges, scows, etc.; cost of supervision, cutting up condemned work cars, and repairing cars of foreign lines damaged on the line while in a carrier's work service; material used by car inspectors and car repair men while engaged in inspecting and making light repairs; small hand tools used exclusively in inspecting and repairing work equipment; expenses of fitting cars with devices for special maintenance-of-way work; traveling expenses of employees whose pay is chargeable to this account; payments of royalties or for patent rights on brakes, brake fixtures, and other appliances used on work or service equipment; and payment for cars of foreign lines destroyed on the line while in a carrier's work service; also proportion of shop expenses as provided in Note following account "Other Expenses" under head of "Maintenance of Equipment."

The value of old material released during repairs, insurance recovered, and repayments from other roads should be credited to this account.

NOTE A.—The following equipment is classified as work equipment:

Ballast,	Outfit,	Steam shovels,
Ballast, unloader cars,	Painters,	Steam wrecking der-
Boarding,	Pile drivers,	ricks,
Bridge,	Rail saw,	Supply,
Camp,	Scale test,	Sweeper,
Cinder,	Snow dozer,	Tool,
Derriek,	Snow drags,	Tool and block,
Ditching,	snowplows (not attached	Water,
Dump,	to locomotives, but	Weed burner,
Grading,	moved by them),	Wrecking,
Gravel,	Sprinkling,	

NOTE B.—The word "repairs" as here used includes all repairs to or renewals of parts of work equipment commonly known as running repairs; also repairs or renewals of the more important or vital parts of work equipment, the necessity for which is caused by breakage or failure while in service; also the repairs to work equipment damaged through accident or otherwise necessary to restore it to service; and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

**NOTE C.**—The cost of repairing work equipment of foreign lines waybilled as freight, damaged in transit should be charged to account "Loss and Damage—Freight," and damage to work equipment of foreign lines having trackage rights over a carrier's lines damaged in collision or wrecks for which a carrier is liable should be charged to account "Damage to Property."

### WORK EQUIPMENT—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all work equipment condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of work equipment retired.

**NOTE.**—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

### WORK EQUIPMENT—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of per cent per annum of the original cost (estimated, if not known), record value, or purchase price of work equipment, to provide a fund for replacement when retired.

### INJURIES TO PERSONS.

This account includes all expenses incident to injuries to persons when caused directly in connection with maintenance of way and structures; proportion of salaries and expenses of physicians and surgeons, expenses of undertakers, nursing and hospital attendance, medical and surgical supplies, artificial limbs, funeral expenses, railway and carriage fares for conveying injured persons and attendants, also proportion of pay and expenses of claim adjusters and their clerks, and pay and expenses of employees and others called in consultation in relation to the adjustment of claims coming under this head.

**NOTE A.**—Witness fees and other expenses in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

**NOTE B.**—When contributions are made to hospitals, the total thereof should be distributed to the several "Injuries to Persons" accounts as follows: 25 per cent to "Maintenance of Way and Structures," 25 per cent to "Maintenance of Equipment," and 50 per cent to "Transportation Expenses."

NOTE C.—The pay and expenses of claim adjusters, clerks, chief surgeons, and others whose pay can not be actually allocated to any case should be divided equally between personal injury and other claims over which they have jurisdiction.

## STATIONERY AND PRINTING.

This account includes the cost of stationery, stationery supplies, printing, books, and blank forms used in connection with "Maintenance of Way and Structures." (Dictionaries, periodicals, technical books, etc., should be charged to account "Superintendence.")

The following is a list of the more important items chargeable to this account:

Adding machines,	Eyelet punches,	Pins,
Addressographs and supplies,	Forms,	Postage,
Arm rests,	Glass pens,	Printed cards,
Binders,	Hektographs,	Printed tablets,
Blank books,	Indexes,	Profile books and paper,
Blank cards,	Ink for writing and drawing,	Punches (not conductors' or baggagemen's),
Blank forms,	Inkstands,	Rubber bands,
Blank paper,	Invoice books,	Rubber stamps,
Blank tablets,	Legal-cap paper,	Rulers,
Blotters,	Letter paper,	Ruling pens,
Blotting paper,	Manifold paper,	Scrapbooks,
Blue print paper,	Manifold pens,	Sealing wax,
Books for field notes,	Mimeographs,	Seals,
Bristol board,	Mucilage,	Shears,
Calculating machines,	Mucilage brushes,	Shipping tags,
Calendars,	Neostyles,	Shorthand notebooks,
Caligraphs,	Note paper,	Sponges,
Carbon paper,	Notices,	Sponge cups,
Cardboard,	Numbering stamps,	Stamps, impression,
Cards,	Oil paper,	Stylographs,
Circulars,	Orders,	Tablets,
Computing tables,	Paper,	Tape,
Copy (impression) books,	Paper baskets,	Telegraph blanks,
Copying brushes,	Paper clips,	Tissue (impression) paper,
Copying presses,	Paper cutters,	Tracing cloth,
Crayons,	Paper fasteners,	Tracing paper,
Cross-section books,	Paper files,	Twine,
Cross-section paper,	Paper weights,	Typewriters and ribbons,
Cyclotypes,	Papyrographs,	Wastebaskets,
Dating stamps and ribbons,	Parchment paper,	Water colors,
Drawing paper,	Pencils for writing and drawing,	Water holders,
Duplicators,	Pencil sharpeners,	Wage tables,
Electric pens,	Pens for writing and drawing,	Wrapping paper,
Envelopes,	Penholders,	Wringers for copying presses,
Erasers, rubber and steel,	Penracks,	
Eyelets,		

## INSURANCE.

This account includes all premiums made or paid by a carrier to its insurance fund and premiums (except reinsurance premiums) paid by it to insurance companies for insuring buildings and other structures, work equipment of all classes, other property, and persons against loss, damage, or injury by fire, accident, or other causes when such loss, damage, or injury would otherwise be chargeable to "Maintenance of Way and Structures."

NOTE A. The premiums paid by a carrier to its insurance fund should be credited on its books to an "Insurance Fund" account, to which the amount of all claims for damages to the property covered by its insurance should be charged. To such account should be charged all reinsurance premiums paid insurance companies, and to it should be credited all amounts recovered from insurance companies for damage to property reinsured by them.

NOTE B. Appropriations made by a carrier to its insurance fund through Income Account should be credited directly to its "Insurance Fund" account.

## OTHER EXPENSES.

This account includes all expenses in connection with maintenance of way and structures not properly chargeable to other "Maintenance of Way and Structures" accounts.

## MAINTAINING JOINT TRACKS, YARDS, AND OTHER FACILITIES—DR.

This account includes a carrier's proportion of costs incurred to maintain joint tracks, yards, terminals, and other facilities maintained by other companies.

NOTE. The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of maintaining joint tracks, yards, and other way and structure facilities maintained by other companies, but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

## MAINTAINING JOINT TRACKS, YARDS, AND OTHER FACILITIES—CR.

This account includes the proportion of costs to maintain joint tracks, yards, terminals, and other facilities maintained by a carrier chargeable to other companies.

NOTE. The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of maintaining joint tracks, yards, and other way and structure facilities maintained by a carrier, but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor and such distribution should be adhered to by the debtor.

## II. MAINTENANCE OF EQUIPMENT.

### SUPERINTENDENCE.

This account includes:

**PAY OF OFFICERS.**—Pay of vice-president or assistant when directly in charge of equipment, general superintendent of motive power, assistant to general superintendent of motive power, mechanical superintendent, superintendent of motive power, mechanical engineer, assistant mechanical engineer, chief chemist, engineer of tests, assistant engineer, supervisor of car department, electrical engineer, assistant electrical engineer, chemist, assistant chemist, master car builder, master mechanic, general foremen, chief car inspector, traveling boiler inspector, general car inspector, and other officials engaged in the maintenance-of-equipment department.

**PAY OF CLERKS AND ATTENDANTS.**—Pay of chief motive power clerk, chief and other clerks, motive power clerks and their assistants, shop clerks, draftsmen, and attendants in offices and on special cars of officers whose pay is charged to this account.

**OFFICE AND OTHER EXPENSES.**—Rent and cost of repairing rented offices, rent and cost of telephone service, telegraph messages, heat, light, ice, water, furniture, and supplies for offices of officers whose pay is charged to this account; incidental office and traveling expenses of such officers and their clerks; cost of provisions for and expenses of special cars when used by them; and cost of running special trains for officials mentioned; premiums on fidelity bonds, and dues of

such officers and their assistants for membership in master mechanics' and master car builders' associations.

Cost of drafting and engineering instruments and expenses of repairing them; also cost of supplies (except stationery and printing) used by officers and employees whose pay is charged to this account, such as atlases, barometers, books scientific and reference, boxes for blue prints, boxes for drawing instruments, cameras and supplies therefor, compasses, surveys, directories, drawing boards, drawing instruments, field glasses, magnifiers, oil stones, pantographs, parallel rulers, periodicals, plane tables, planimeters, reading glasses, scales, slide rules, straightedges, tacks for drawing boards, tapelines, tee squares, telescopes, thermometers, tin boxes for tracings and prints, triangles, tripods, and verniers.

NOTE A. When employees enumerated above are engaged on construction or other work not chargeable to "Maintenance of Equipment," their pay and expenses should be charged to the specific work on which engaged.

NOTE B.—When officers and others above enumerated have supervision over other departments also, their salaries and expenses should be apportioned equally between the departments over which they have jurisdiction.

#### STEAM LOCOMOTIVES—REPAIRS

This account includes cost of material used (less salvage) and labor expended in repairing steam locomotives and tenders, and fixtures thereof (except as otherwise provided for); such as air signal equipment, including hose, arm rests, awnings, brake fixtures, cab and steam-gage lamps, cab cushions, clocks, coal boards, fire extinguishers permanently attached to locomotives, gongs, head lamps, pneumatic sanding equipment, seat boxes, speed recorders, steam and other power brakes, steam-heat appliances, including hose and all other appliances of like nature, storm doors, tool boxes; also cost of supervision; pay of locomotive inspectors engaged in inspecting all parts of locomotives and tenders (except pay of smokestack and ash-pan inspectors, which should be charged to account "Enginehouse Expenses—Yard" or "Enginehouse Expenses—Road"), pay of employees engaged in sponging tender, driving and truck boxes of locomotives undergoing repairs in shops but pay of employees similarly engaged on locomotives not undergoing repairs in shops should be charged to account "Enginehouse Expenses—Yard" or "Enginehouse Expenses—Road"), and cost of cutting up condemned loco-



motives and tenders; small hand tools used exclusively in locomotive repairs; special service, such as bringing locomotives to shops or watching them while on the way to shops for repairs, and trying locomotives after having been repaired; traveling expenses of employees whose pay is chargeable to this account; and payments of royalties, or for patent rights on brakes, brake fixtures, and other appliances used on locomotives; also proportion of shop expenses as provided in Note following account "Other Expenses."

The value of old material released during repairs and insurance recovered should be credited to this account.

NOTE A.—The word "repairs" as here used includes all repairs on or renewals of parts of locomotives and tenders commonly known as steam-locomotive fixtures or attachments, and classified as running or roundhouse repairs; also repairs to or renewals of the more important or vital parts of locomotives and tenders, the necessity for which is caused by breakage, failure, or accident while in service; also the repairs to a steam locomotive or tender damaged through accident or otherwise, necessary to restore it to service; and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

NOTE B.—The cost of repairing steam locomotives and tenders of foreign lines waybilled as freight, damaged in transit, should be charged to account "Loss and Damage—Freight," and the cost of repairing steam locomotives of foreign lines having trackage rights over a carrier's line damaged in collision or wreck for which a carrier is liable should be charged to account "Damage to Property."

#### STEAM LOCOMOTIVES—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all steam locomotives condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of steam locomotives retired.

NOTE A.—Steam locomotives permanently retired from service, but held, pending disposition, should be written out of service through this account, and carried in an appropriate material account at a nominal valuation, or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

### STEAM LOCOMOTIVES—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of per cent per annum of the original cost (estimated, if not known), record value, or purchase price of steam locomotives, to provide a fund for replacement when retired.

### ELECTRIC LOCOMOTIVES—REPAIRS.

This account includes all costs analogous to those set forth under the account "Steam Locomotives—Repairs."

NOTE A.—The word "repairs" as here used includes all repairs to or renewals of parts of electric locomotives commonly known as fixtures or attachments, and classified as running or round-house repairs; also repairs to or renewals of the more important or vital parts of electric locomotives, the necessity for which is caused by breakage, failure, or accident while in service; also repairs to an electric locomotive, damaged through accident or otherwise, necessary to restore it to service; and also renewals of important or vital parts made necessary by reason of wear and tear from use.

NOTE B.—The cost of repairing electric locomotives of foreign lines waybilled as freight, damaged in transit, should be charged to account "Loss and Damage—Freight," and the cost of repairing electric locomotives of foreign lines having trackage rights over a carrier's line damaged in collision or wreck for which a carrier is liable should be charged to account "Damage to Property."

### ELECTRIC LOCOMOTIVES—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all electric locomotives condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of electric locomotives retired.

NOTE A.—Electric locomotives permanently retired from service, but held, pending disposition, should be written out of service through this account, and carried in an appropriate material account at a nominal valuation, or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

## ELECTRIC LOCOMOTIVES—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of per cent per annum of the original cost (estimated, if not known), record value, or purchase price of electrical locomotives to provide a fund for replacement when retired.

## PASSENGER-TRAIN CARS—REPAIRS.

This account includes cost of material used (less salvage) and labor expended in repairing, painting, varnishing, finishing, and lettering railway passenger-train cars of all classes (see "Note A" under this account), and cost of repairing and renewing furniture and fixtures thereof, such as brake gear, carpets, cases, chairs, coal boxes, coat hooks, curtains, cushions, electric bells, ice boxes, ice tanks, lamp canopies, lamps (except signal or train), linoleum, mail catchers, mats, matting, pigeon-holes, racks, ranges, rugs, signal and bell cord hangers, speed recorders, stoves, tiles, water tanks; cost of material used and labor expended in cleaning or scrubbing preparatory to painting; scraping and burning off old paint; reupholstering seats and chairs; rewiring, repairing, and renewing curtains and fixtures; cost of electric-lighting fixtures permanently attached to cars; gas tanks, gas gages, and gas, oil, and carburetor lamps; piping and other permanent fixtures used in gas lighting; all appliances used in carburetor lighting permanently attached to and forming part of a car; steam pipes, radiators, and other permanent appliances for heating cars, including steam-heat hose; also cost of supervision; pay of car inspectors while engaged in inspecting passenger-train cars, and cost of cutting up such cars when condemned; also repairs made to passenger-train cars of foreign lines in service of a carrier for which it is responsible. Cost of testing air brakes; material used by car inspectors and car repair men while engaged in inspecting and making light repairs to cars at stations, yards, and elsewhere. Cost of small hand tools used exclusively in inspecting and repairing passenger-train cars; traveling expenses of employees whose pay is chargeable to this account, and payments of royalties, or for patent rights on brakes, brake fixtures, and other appliances used on passenger-train cars; payments to foreign lines for passenger-train cars belonging to such lines destroyed on the line of a

carrier while in its service; also proportion of shop expenses as provided in Note following account "Other Expenses."

The value of old material released during repairs, insurance recovered, and repayments from other roads, should be credited to this account.

The cost of repairing special features of passenger-train cars, the operations of which are treated as "Outside Operations," should not be charged to this account.

NOTE A.—The following cars are classified as passenger-train cars:

Air-brake instruction,	Dining,	Passenger,
Baggage,	Emigrant,	Passenger—baggage—
Baggage—express,	Express,	mail,
Baggage—mail,	Library,	Pay,
Buffet,	Mail,	Postal,
Business,	Milk,	Refrigerator—express,
Café,	Observation,	Smoking,
Chair,	Officers',	Street,
Colonist,	Parlor,	Tourist,
Combination passenger and baggage,	Parlor—baggage,	

NOTE B.—The word "repairs" as used here includes all repairs to or renewals of parts of passenger-train cars, commonly known as fixtures or attachments and classified as running repairs; also repairs to or renewals of the more important or vital parts of passenger-train cars, the necessity for which is caused by breakage or failure while in service; also the repairs to passenger-train cars, damaged through accident or otherwise, necessary to restore them to service; and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

NOTE C.—The cost of repairing passenger-train cars of foreign lines waybilled as freight, damaged in transit, should be charged to account "Loss and Damage—Freight," and the cost of repairing passenger-train cars of foreign lines having trackage rights over a carrier's line damaged in collision or wreck for which a carrier is liable should be charged to account "Damage to Property."

## PASSENGER-TRAIN CARS—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all passenger-train cars condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of passenger-train cars retired.

The cost of renewing passenger-train cars, the operations of which are treated as "Outside Operations" (except dining, café, and buffet cars) should not be charged to this account.

NOTE A.—Passenger-train cars permanently retired from service but held, pending disposition, should be written out of service through this account, and carried in an appropriate material account at a nominal valuation or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

#### PASSENGER-TRAIN CARS—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of      per cent per annum of the original cost (estimated, if not known), record value, or purchase price of passenger-train cars, to provide a fund for replacement when retired.

The charge for depreciation on passenger-train cars, the operations of which are treated as "Outside Operations" (except dining, café, and buffet cars) should not be charged to this account.

#### FREIGHT-TRAIN CARS—REPAIRS.

This account includes cost of material used (less salvage) and labor expended in repairing, painting, and lettering freight-train cars of all classes (see "Note A" under this account), furniture for cabin or caboose cars, and fixtures for all freight-train cars, including cost of renewing same; such as brake gear, coal boxes, coal hods, curtains, cushions, deck lamps, flag and torpedo boxes when attached to cars, ice boxes, lamp fixtures, links and pins, racks, stoves and fixtures; also cost of fixed or permanent grain doors and lumber for them; racks and ventilating systems for refrigerator cars, and material used and labor expended in double-decking cars for live stock; also cost of supervision; pay of car inspectors while engaged in inspecting freight-train cars; and cost of cutting up such cars when condemned; also repairs, for which a carrier is liable, made to freight-train cars of foreign lines in its service. Cost of testing air brakes; material used by car inspectors and car repair men while engaged in inspecting and making light repairs to cars at stations, yards, and elsewhere. Small hand tools used exclusively in inspecting and repairing freight-train cars. Traveling expenses of employees whose pay is chargeable to this account; expenses of light-

weighing freight-train cars, payments of royalties, or for patent rights on brakes, brake fixtures, and other appliances used on freight-train cars, payments for foreign freight-train cars destroyed on the line while in a carrier's service, or to foreign roads for repairs to a carrier's freight-train cars, also proportion of shop expenses as provided in Note following account "Other Expenses."

The value of old material released during repairs, insurance recovered, and repayments from other roads should be credited to this account.

NOTE A.—The following cars are classified as freight-train cars:

Beer,	Furniture,	Feline,
Box,	Gondola,	Poultry,
Cabin,	Gondola-hopper,	Produce,
Caboose,	Gondola-hong,	Rack,
Charcoal,	Gun-trucks,	Refrigerator,
Coal,	Hay,	Stock,
Coke,	Lime,	Tank and water (when used on commercial cars),
Dump (commercial), Logging,	Lumber,	
Coal or stone,	Oil tank,	
Flat,	ore,	
Freight,	Platform,	

NOTE B.—The word "repairs" as here used includes all repairs to, or renewals of parts of freight-train cars commonly known as running repairs, also repairs to, or renewals of the more important or vital parts of freight-train cars, the necessity for which is caused by breakage or failure while in service; also the repairs to freight-train cars damaged through accident or otherwise, necessary to restore them to service, and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

NOTE C.—The cost of repairing freight-train cars of foreign lines waybilled as freight damaged in transit should be charged to account "Loss and Damage—Freight," and the cost of repairing freight-train cars of foreign lines having trackage rights over a carrier's line damaged in collision or wreck for which a carrier is liable should be charged to account "Damage to Property."

## FREIGHT-TRAIN CARS—RENEWALS.

This account includes the original cost estimated, if not known, record value, or purchase price of all freight-train cars condemned, destroyed, or sold, *Less*:

(a) Amount previously charged for depreciation up to date of retirement.

(b) Scrap value of salvage or the amount received from sale of freight-train cars retired.

NOTE A.—Freight-train cars or parts thereof (such as trucks) permanently retired from service, but held, pending disposition, should be written out of service through this account and car-

ried in an appropriate material account at a nominal valuation or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

#### FREIGHT-TRAIN CARS—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of per cent per annum of the original cost (estimated, if not known), record value, or purchase price of freight-train cars to provide a fund for replacement when retired.

#### ELECTRIC EQUIPMENT OF CARS—REPAIRS.

This account includes cost of material used and labor expended in repairing and renewing motors affixed to cars, and their connections, as distinguished from independent electric locomotives used in connection with electric power for the propulsion of trains or cars, dynamo covers, rheostats, reversing, cut-out, and main motor switches, power boxes, motor boxes, power levers, trolley poles, trolleys, third-rail contact appliances, wiring, inspecting, cables, lightning arresters, pans, brush holders, and motor pans.

NOTE.—The word "repairs" as here used includes all repairs to or renewals of parts of electric equipment of cars commonly known as running repairs, also repairs to or renewals of the more important or vital parts of electric equipment of cars, the necessity for which is caused by breakage or failure while in service; also the repairs to electric equipment of cars damaged through accident or otherwise, necessary to restore it to service; and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

#### ELECTRIC EQUIPMENT OF CARS—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all electric equipment of cars condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of electric equipment of cars.

NOTE A.—Electric equipment of cars permanently retired from service, but held, pending disposition, should be written out of service through this account, and carried in an appropriate

material account at a nominal valuation, or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

### ELECTRIC EQUIPMENT OF CARS—DEPRECIATION.

This account includes a monthly charge of one-twelfth of  $\frac{1}{12}$  per cent per annum of the original cost (estimated, if not known), record value, or purchase price of electric equipment of cars to provide a fund for replacement when retired.

### FLOATING EQUIPMENT—REPAIRS.

This account includes, when not chargeable to "Outside Operations:"

STEAMBOATS AND TUGBOATS. Cost of material used and labor expended in repairing steamships, steamboats, power launches, steam lighters, ferry, transfer, tug, and all other boats propelled by their own power (see "Note A" under this account); also boilers, engines, masts, rigging, sails, wood foundations, bearings for machinery, wheels, rudders, shafts, steering gear, ventilators, electric plants, steam and hot-water fixtures, and all other parts; furniture and fixtures of such boats, including cost of renewing machinery, furniture, and fixtures, such as anchors, axes, barometers, beds and bedding, binnacle lamps, block and tackle, capstan bars, carpets, chairs, charts, clocks, compasses, copying presses, counters, desks, engine furnishings, fire buckets, fire extinguishers, flue cleaners, gang planks, hatchets, hooks, keys, lamps (when permanently attached to boats), life-preservers, lines, linoleum, logs and log lines, mats, matting, mattresses, oil cans, pianos on passenger boats, pillows, poker, racks, railings, rugs, safes, scales, scrapers, settees, shovels, splice bars, spyglasses, stoves and stove furniture, tables, ticket cases and fixtures, tool boxes, tools, wrenches; payments of royalties, or for patent rights on improved machinery. Pay and expenses of shore engineers, shore captains, and their assistants when engaged in supervising the maintenance of floating equipment.

The value of old material released during repairs and insurance recovered should be credited to this account.

BARGES, CAR FLOATS, AND CANAL BOATS.—Cost of material used and labor expended in repairing barges, canal boats,



car and other floats, dredges, lighters, and scows (see "Note B" under this account); also hulls, decks, cabins, rigging, and all other parts and furniture and fixtures of such boats, including cost of renewing machinery, furniture, and fixtures, such as those enumerated above.

The value of old material released during repairs and insurance recovered should be credited to this account.

NOTE A.—The following floating equipment is classified as steamboats and tugboats:

Ferryboats,	Steamboats,	Tugboats.
Power launches,	Steamships,	
Power lighters,	Transfer boats,	

NOTE B.—The following floating equipment is classified as barges, car floats, and canal boats:

Larges,	Car floats,	Lighters,
Canal boats	Dredges,	Scows.

NOTE C.—The word "repairs" as here used includes all repairs to or renewals of minor parts of floating equipment; also repairs to or renewals of the more important or vital parts of floating equipment, the necessity for which is caused by breakage, failure, or accident while in service; also the repairs to floating equipment damaged through accident or otherwise, necessary to restore it to service; and also renewals of important or vital parts made necessary by reason of age or wear and tear from use.

#### FLOATING EQUIPMENT—RENEWALS.

This account includes the original cost (estimated, if not known), record value, or purchase price of all floating equipment condemned, destroyed, or sold, less:

(a) Amount previously charged for depreciation up to date of retirement;

(b) Scrap value of salvage or the amount received from sale of floating equipment retired.

The cost of renewing floating equipment, the operations of which are treated as "Outside Operations," should not be charged to this account.

NOTE A.—Floating equipment permanently retired from service, but held, pending disposition, should be written out of service through this account, and carried in an appropriate material account at a nominal valuation or at actual scrap value, if determinable.

NOTE B.—The term "record value" should not be interpreted to mean the value of equipment as it stands in the capital account, unless that account represents the original value of the equipment on hand.

## FLOATING EQUIPMENT—DEPRECIATION.

This account includes a monthly charge of one-twelfth ( $\frac{1}{12}$ ) of per cent per annum of the original cost (estimated, if not known), record value, or purchase price of floating equipment, to provide a fund for replacement when retired.

The charge for depreciation on floating equipment, the operations of which are treated as "Outside Operations" should not be charged to this account.

## SHOP MACHINERY AND TOOLS.

This account includes:

**REPAIRS.** Cost of material used, and labor expended in repairing tools and machinery in enginehouses and at locomotive and car shops and foundries, including stationary engines and boilers for furnishing power; scaffolds, shafting, belting, and other appliances for running machinery, cranes, hoists (power and hand), drop tables, jacks, and other appliances used in connection therewith; also in repairing furnaces, forges, hydraulic and other portable jacks, portable scales, and sewing machines used in shops. Cost of repairing heating boilers should be charged to account "Buildings, Fixtures, and Grounds."

**RENEWALS.** Cost of new tools and machinery (less salvage), used in enginehouses and at locomotive and car shops and foundries, including stationary engines and boilers for furnishing power; scaffolds, shafting, belting, and other appliances for running machinery, cranes, hoists (power and hand), drop tables, jacks and other appliances used in connection therewith; also furnaces, forges, hydraulic and other portable jacks, portable scales and sewing machines used in shops. Cost of renewing heating boilers should be charged to account "Buildings, Fixtures, and Grounds."

## POWER PLANT EQUIPMENT.

This account includes:

**STEAM AND WATER PLANT.** Cost of materials used (less salvage) and labor expended in repairing and renewing steam and water plant equipment, including engines and engine parts, appliances, and fixtures; belts, belt tighteners and fixtures; receivers, lubricators, and oiling devices, shafting, clutches, cranes, hoists, and other engine-room appliances, boilers, boiler fittings, and appliances, furnaces, economizers, stacks, mechanical draft machinery, pumps, feed-water heaters, puri-

fiers, tanks, condensers, coal and ash conveying machinery, mechanical stokers, and other boiler-room appliances; piping and steam fitting, including valves, separators, water and sewer connections, and water meters.

**ELECTRIC PLANT.**—Cost of materials used and labor expended in repairing and renewing all electric equipment within the power house (not including the method of transmission of power beyond the power house), including generators and generator parts, dynamos, switch boards, cables, and feeder terminals, and wiring in connection therewith; storage batteries, transformers, boosters, rheostats, circuit breakers, meters, and other electric equipment.

#### INJURIES TO PERSONS.

This account includes all expenses incident to injuries to persons when caused directly in connection with maintenance of equipment; proportion of salaries and expenses of physicians and surgeons, expenses of undertakers, nursing and hospital attendance, medical and surgical supplies, artificial limbs, funeral expenses, railway and carriage fares for conveying injured persons and attendants; also proportion of pay and expenses of claim adjusters and their clerks, and pay and expenses of employees and others called in consultation in relation to the adjustment of claims coming under this head.

**NOTE A.**—Witness fees and other expenses in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

**NOTE B.**—When contributions are made to hospitals, the total thereof should be distributed to the several "Injuries to Persons" accounts as follows: 25 per cent to "Maintenance of Way and Structures," 25 per cent to "Maintenance of Equipment," and 50 per cent to "Transportation Expenses."

**NOTE C.**—The pay and expenses of claim adjusters, clerks, chief surgeons, and others whose pay can not be actually allocated to any case should be divided equally between personal injury and other claims over which they have jurisdiction.

#### STATIONERY AND PRINTING.

This account includes the cost of all stationery, stationery supplies, printing, books, and blank forms used in connection with maintenance of equipment. (Dictionaries, periodicals, technical books, etc., should be charged to account "Superintendence.")

The following is a list of the more important items chargeable to this account.

Adding machines,	Glass pens,	Pins,
Addressographs and supplies,	Hektographs,	Postage,
Arm rests,	Indexes,	Printed cards,
Binders,	Ink, for writing and drawing,	Printed tablets,
Blank books,	Ink stands,	Punches (not conductors' or baggage-men's),
Blank cards,	Invoice books,	Rubber bands,
Blank forms,	Legal cap paper,	Rubber stamps,
Blank paper,	Letter paper,	Rulers,
Blank tablets,	Manifold paper,	Ruling pens,
Blotters,	Manifold pens,	Scrap books,
Blotting paper,	Mimeographs,	Sealing wax,
Blue print paper,	Mucilage,	Seals,
Bristol board,	Mucilage brushes,	Shears,
Calculating machines,	Neostyles,	Shipping tags,
Calendars,	Note paper,	Shorthand notebooks,
Caligraphs,	Notices,	Sponges,
Carbon paper,	Numbering stamps,	Sponge cups,
Cardboard,	Oil paper,	Stamps, impression,
Cards,	Orders,	Stylographs,
Circulars,	Paper,	Tablets,
Computing tables,	Paper baskets,	Tape,
Copy (impression) books,	Paper clips,	Telegraph blanks,
Copying brushes,	Paper cutters,	Tissue (composition) paper,
Copying presses,	Paper fasteners,	Tracing cloth,
Crayons,	Paper files,	Tracing paper,
Cyclostyles,	Paper weights,	Twine,
Dating stamps and ribbons,	Papytographs,	Typewriters and ribbons
Drawing paper,	Parchment paper,	Waste baskets,
Duplicators,	Pencils, for writing and drawing,	Water colors,
Electric pens,	Pencil sharpeners,	Water holders,
Envelopes,	Penholders,	Wage tables,
Erasers, rubber and steel,	Penracks,	Wrapping paper,
Eyelets,	Pens, for writing and drawing,	Wringers for copying presses,
Eyelet punches,		
Forms,		

## INSURANCE.

This account includes all premiums made or paid by a carrier to its insurance fund and premiums (except reinsurance premiums) paid by it to insurance companies for insuring all equipment and other property and persons against loss, damage, or injury by fire, accident, or other causes, when such loss, damage, or injury would otherwise be chargeable to "Maintenance of Equipment."

NOTE A. The premiums paid by a carrier to its insurance fund should be credited on its books to an "Insurance Fund" account, to which the amount of all claims for damages to the property covered by its insurance should be charged. To such account should be charged all reinsurance premiums paid insurance companies, and to it should be credited all amounts recovered from insurance companies for damage to property insured by them.

NOTE B. Appropriations made by a carrier to its insurance fund through Income Account should be credited directly to its "Insurance Fund" account.

## OTHER EXPENSES.

This account includes all expenses in connection with maintenance of equipment not properly chargeable to other "Maintenance of Equipment" accounts.

## EXPLANATORY NOTE—CLEARING ACCOUNT "SHOP EXPENSES."

It is recognized that costs incident to maintenance of equipment other than those enumerated herein not chargeable directly to any particular account provided, will be incurred, such as heating, lighting, water, watchmen, and incidentals. To provide for the distribution of such costs to proper expense accounts, a clearing account called "Shop Expenses" should be opened, to which these items and other unassignable items of expense at shops, enginehouses, repair tracks, and other places at which mechanical work is done should be charged. Such shop expenses should be apportioned among the various accounts affected on the basis of the amount of distributed labor charged to those accounts. The basis of distribution should be the relative proportion which the total amount of charges to "Shop Expenses" bears to the total of the distributed labor.

To avoid monthly fluctuations in the percentage of shop expenses to the total of distributed labor, carriers will be permitted to make the monthly apportionment on the basis of a fixed percentage for the fiscal year, provided the "Shop Expenses" account is adjusted and closed out at the end of that year.

The expenses above referred to are as follows:

**FUELING.** Cost of fuel, including freight charges and handling, if any, used for heating shops and shop offices, repair tracks, and other places at which mechanical work is done, watchmen's and gate keepers' boxes, and inspectors' shanties.

**LIGHTING.** Cost of electric current, gas, torches, lamp burners, lamp chimneys, lamps when not permanently attached to buildings, oil, incandescent lamps and carbons, and other material used for lighting shops and shop offices, repair tracks, and other places at which mechanical work is done; and cost of material used and labor expended in operating electric light plants and repairing electric light lamps at shops.

**WATER.** Cost of water used in shops and shop offices, repair tracks, and other places at which mechanical work is done.

**WATCHMEN.** Pay of watchmen, gate keepers, and policemen at shops, repair tracks, and other places at which mechanical work is done.

**INCIDENTALS.** Pay of employees while attending fires and fire drills, cost of supplies for test rooms and laboratories incident to shop work, ice for shops, watchmen's uniforms, clocks, and call boxes, removing snow and ice from transfer tables and shop yards, traveling expenses not chargeable to other accounts, cost of cleaning privy vaults, oil, grease, waste, and other material used in lubricating shop machinery and tools, horses and horse keep, and repairing wagons and harness used in connection with shops, cost of supplies and small hand tools used by mechanics on miscellaneous work and soon worn out, and pay of employees while making, repairing, or having charge of same, pay of shop foremen, assistant foremen, clerks, time keepers, and shop accountants, stationary engineers and firemen, sweepers, cleaners, roundabouts, and other unskilled laborers employed in general work in and about shops and shop grounds; cost of fuel for forges, fuel, stores, and supplies, and other undistributed shop expenses, all expenses of switching locomotives, including wages, repairs, fuel, and supplies when exclusively assigned to switching service at shops. (When switching at shops is performed by locomotives in regular switching service, all expenses of such switching should be charged to appropriate "Maintenance" and "Transportation" accounts.)

**NOTE.** When shops, shop offices, repair tracks, and other places at which mechanical work is done, are supplied with heat from boilers used for running machinery, or with heat or light from plants used for heating, lighting, or other purposes, a proportion of the cost of such heat or light should be charged to this account on the basis of the service performed.

The following is a list of the more important supplies and small tools used in shop work:

- Acid,  
 Adze handles,  
 Adzes,  
 Ammonia,  
 Auger bits,  
 Auger handles,  
 Augers,  
 Ax handles,  
 Axes,  
 Basins,  
 Bath brick,  
 Battery brushes,  
 Beeswax,  
 Bell cord,  
 Bits,  
 Bluestone,  
 Bone, granulated,  
 Borax,  
 Bottles,  
 Braces,  
 Brooms,  
 Brushes, dust,  
 Brushes, oil,  
 Brushes, paint,  
 Brushes, scrub,  
 Brushes, sweeping,  
 Brushes, varnish,  
 Brushes, wall,  
 Brushes, whitewash,  
 Brushes, window,  
 Buckets,  
 Carpenter tools furnished  
   apprentices,  
 Casehardening,  
 Cement (belt),  
 Chalk,  
 Chalk lines,  
 Chamois skins,  
 Charcoal,  
 Clamps, hand,  
 Coal-pick handles,  
 Coal picks,  
 Compound for B. S. ham-  
   mers,  
 Compound for welding,  
 Corks,  
 Cosmetic (to prevent rust),  
 Crayon,  
 Cushion beaters,  
 Ditching lines,  
 Drinking cups,  
 Drinking glasses,  
 Dustpans,  
 Emery,  
 Emery boxes,  
 Emery cloth,  
 Emery paper,  
 Faucets,  
 File brushes,  
 File cards,  
 File handles,  
 Files,  
 Fire hooks (stationary  
   boilers),  
 Fire shovels (stationary  
   boilers),  
 Flags,  
 Fork handles,  
 Forks,  
 Forks, coke,  
 Flannel, cotton,  
 Funnels,  
 Girdlets,  
 Glue,  
 Gluepots,  
 Glycerine,  
 Graphite,  
 Grinding compound,  
 Ground glass,  
 Hack-saw blades,  
 Hammers,  
 Hammers, babbitt,  
 Hand leathers,  
 Handles,  
 Hatchets,  
 Hoes,  
 Hydraulic jack com-  
   pound,  
 Keel,  
 Lampblack,  
 Lead,  
 Lead, red,  
 Lye,  
 Mallets,  
 Marking brushes,  
 Marking pots,  
 Measures, liquid,  
 Metallic tapes,  
 Mineral paste,  
 Mops,  
 Mop handles,  
 Muslin,  
 Oil cans,  
 Oilstones,  
 Padlocks,  
 Paint pots,  
 Picks,  
 Pipe-joint grease,  
 Pliers,  
 Plumbago,  
 Polish,  
 Polish, stove,  
 Potash,  
 Prisms,  
 Rail cutters,  
 Rakes,  
 Raps,  
 Ratchet braces,  
 Resin,  
 Rope,  
 Rules,  
 Sal ammoniac,  
 Sandpaper,  
 Sand soap,  
 Saw blades,  
 Saws, hand,  
 Scoops,  
 Screwdrivers,  
 Screwdrivers, ratchet,  
 Screws,  
 Shellac,  
 Shovels,  
 Slates,  
 Slate pencils,  
 Sledges,  
 Soap,  
 Soda,  
 Solder,  
 Soldering fluid,  
 Spelter solder,  
 Spigots (oil barrels),  
 Spirit levels,  
 Spirit-level vials,  
 Sponges,  
 Sprinkling cans,  
 Squares,  
 Squirts (lubricating),  
 Stencil brushes,  
 Tacks,  
 Tapelines,  
 Tin cups,  
 Tool steel, for small hand  
   tools,  
 Tripoli,  
 Trucks,  
 Twine,  
 Wash basins,  
 Wheelbarrows,  
 Whetstones,  
 White lead,  
 Whiting,  
 Window cloths,  
 Wire,  
 Wire brushes,  
 Wrenches, all kinds,  
 Zinc cakes,  
 Zincs.

## EXPLANATORY NOTE—CLEARING ACCOUNT "STORE EXPENSES."

Where the words "Cost of Material" appear herein it is understood that they cover not only the cost of the material, but foreign roads' freight charges and the cost of inspection. Credit should be given for the value of the material removed, if any.

STORE EXPENSES. A memorandum account called "Store Expenses" should be opened, to which should be charged the cost of purchasing, handling, storing material in and distributing it from the company's storehouses, including the pay of officers and employees in the purchasing and store departments, and their traveling, office, and other expenses. The total amount charged to this account, representing the "Storehouse Expenses," should be apportioned on the value of the material issued from the store department, and the amount representing the "Purchasing Department" expenses should be apportioned on the value of the material issued which was purchased by that department.

To avoid monthly fluctuations in the percentage of store expenses to the value of material purchased or issued, carriers will be permitted to make a monthly apportionment on the basis of a fixed percentage for the fiscal year, provided the "Store Expenses" account is adjusted and closed out at the end of that year.

When a number of men are employed in the purchasing or inspecting of a single class of material, such as ties, their pay and expenses should be added to the cost of that material and not included in this "Store Expenses" account.

## MAINTAINING JOINT EQUIPMENT AT TERMINALS—DR.

This account includes a carrier's proportion of costs to maintain equipment used for the operation of joint terminals maintained by other companies.

NOTE.—The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of maintaining joint equipment at terminals maintained by other companies but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

## EQUIPMENT BORROWED—DR.

This account includes a portion of the gross rental accruing upon equipment of other companies used by a carrier for the conduct of its business, to cover a proper depreciation on such equipment while so used, in addition to repairs and renewals actually made.

NOTE.—In case of freight-train cars borrowed, 12 cents per car per day, while such cars are on the lines of a carrier,



should be charged to this account. The charge to this account for equipment other than freight-train cars should be determined by special agreement between the carriers, companies, or individuals interested. The amounts debited to this account should invariably equal the amounts credited to the clearing account "Hire of Equipment."<sup>a</sup>

#### MAINTAINING JOINT EQUIPMENT AT TERMINALS—CR.

This account includes the proportion of costs to maintain equipment used for the operation of joint terminals maintained by a carrier chargeable to other companies.

**NOTE.**—The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of maintaining joint equipment at terminals maintained by a carrier, but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

#### EQUIPMENT LOANED—CR.

This account includes a portion of the gross rental received by a carrier from other carriers, companies, or individuals for the use of its equipment while in use by other carriers, companies, or individuals (car service excepted), to cover that portion of depreciation charged to operating expenses during the period covered by a carrier's equipment while in use by other companies.

**NOTE.** In the case of freight-train cars loaned, 12 cents per car per day while such cars are on the lines of other companies should be credited to this account. The credit to this account for equipment other than freight-train cars should be upon the basis of days such equipment is in use by other companies at the same average rate of depreciation upon which charges are made to "Depreciation" in operating expense accounts. The amounts credited to this account should invariably equal the amounts charged to the clearing account "Hire of Equipment."<sup>b</sup>

<sup>a</sup> See paragraph designated as (4) on page 15 in Introductory Letter preceding this Classification.

<sup>b</sup> See paragraph designated as (3a) and (3b) on page 17 in Introductory Letter preceding this Classification.

### III. TRAFFIC EXPENSES.

#### SUPERINTENDENCE.

This account includes:

**PAY OF OFFICERS.**—Pay of vice-president and assistant when directly in charge of traffic, traffic directors, traffic managers, general and assistant freight, coal traffic, passenger, and ticket agents, division and assistant freight and passenger agents, general baggage agent, general express agent, and other officers engaged in the preparation and distribution of tariffs, classifications, rates, and divisions thereof; and other officials engaged in administering traffic.

**NOTE A.**—Pay of officers engaged exclusively in soliciting traffic should be charged to account "Outside Agencies."

**NOTE B.**—When officers and others, above enumerated, have supervision over other departments also, their salaries and expenses should be apportioned equally between the departments over which they have jurisdiction.

**PAY OF CLERKS AND ATTENDANTS.**—Pay of chief and other clerks in offices, and porters and attendants in offices and on special cars of officers whose pay is chargeable to this account.

**OFFICE AND OTHER EXPENSES.**—Rent and cost of repairing rented offices; telephone service, telegraph messages, heat, light, ice, water, furniture, and supplies (except stationery and printing), such as atlases, directories, maps, and periodicals for offices of officers whose pay is charged to this account; incidental office and traveling expenses of such officers and their clerks; cost of provisions for and the expenses of special cars when used by them, and cost of running special trains for officials mentioned; also premiums on fidelity bonds of such officers and their employees.

#### OUTSIDE AGENCIES.

This account includes pay and expenses of general, commercial, city, district, and other agents engaged exclusively in soliciting traffic; employees of their offices, traveling agents, and solicitors whether located on or off the line of road; rent and cost of repairing rented offices (less rent received from subtenants), furniture, supplies, heat, light, ice, water, telephone service, telegraph messages, express charges, and office and other expenses of such agencies; also commissions for services appertaining to either freight or pas-

senger business, except commissions paid a carrier's agents in lieu of salary.

#### ADVERTISING.

This account includes pay and expenses of advertising agents, cost of bill posting, etc., printing, publishing, and distributing passenger time-tables, folders, and notices to shippers for general distribution; printing advertising matter; advertising in newspapers and periodicals for the purpose of securing traffic; bulletin boards, cards, cases, cords, display cars, dodgers, folders, glasses, handbills, maps, pamphlets, posters, racks, frames, tacks, photographs, views, and postage and express charges on advertising matter; donations to carnivals authorized for traffic purposes; and other expenses for attracting traffic.

#### TRAFFIC ASSOCIATIONS.

This account includes expenses of traffic associations, including membership fees in boards of trade, commercial, and other kindred associations.

#### FAST FREIGHT LINES.

This account includes expenses of fast freight or dispatch organizations.

#### INDUSTRIAL AND IMMIGRATION BUREAUS.

This account includes salaries and expenses of industrial and immigration agents, exhibit agents, clerks, and assistants; cost of exhibits; rent and cost of repairing rented offices; telephone service, express charges, office expenses, furniture, supplies, stationery, postage, advertising, and other expenses of a similar nature incident to industrial and immigration bureaus; also expenses of experimental farms and donations to expositions, incident to the upbuilding of traffic, other than those provided for in account "Advertising" and premiums and donations to fairs and stock shows.

#### STATIONERY AND PRINTING.

This account includes the cost of all stationery, stationery supplies, printing, books, and blank forms (except such as are used by industrial and immigration bureaus) used in connection with traffic expenses. (Dictionaries, periodicals, technical books, etc., should be charged to account "Superintendence.")

The following is a list of the more important items chargeable to this account:

Adding machines,	Indexes,	Postage,
Arm rests,	Ink, for writing and drawing,	Printed cards,
Binders,	Inkstands,	Printed tablets,
Blank books,	Invoice books,	Punches (not conductors' or baggage men's),
Blank cards,	Legal-cap paper,	Rubber bands,
Blank forms,	Letter paper,	Rubber stamps,
Blank paper,	Manifold paper,	Rulers,
Blank tablets,	Manifold pens,	Ruling pens,
Blotters,	Mimeographs,	Scrapbooks,
Blotting paper,	Mucilage,	Sealing wax,
Bristol board,	Miscellaneous brushes,	Seals,
Calculating machines,	Neostyles,	Shears,
Calendars,	Note paper,	Shipping tags,
Calligraphs,	Notices,	Shorthand notebooks,
Carbon paper,	Numbering stamps,	Sponges,
Cardboard,	Oil paper,	Sponge cups,
Cards,	Orders,	Stamps, impression,
Circulars,	Paper,	Stylographs,
Computing tables,	Paper baskets,	Tablets,
Copy (impression) books,	Paper clips,	Tape,
Copying brushes,	Paper cutters,	Telegraph blanks,
Copying presses,	Paper fasteners,	Tissue (impression) paper,
Crayons,	Paper files,	Typewriters and ribbons,
Cyclostyles,	Paper weights,	Wastebaskets,
Dating stamps and ribbons,	Papyrographs,	Water colors,
Duplicators,	Passes,	Water holders,
Electric pens,	Pencils, for writing and drawing,	Wage tables,
Envelopes,	Pencil sharpeners,	Wrapping paper,
Erasers, rubber and steel,	Penholders,	Wringers for copying presses,
Eyelets,	Pens, for writing and drawing,	
Eyelet punches,	Penracks,	
Forms,	Pins,	
Glass pens,		
Hektographs,		

**TARIFFS.**—Cost of printing freight and passenger tariffs, classifications, supplements, and rate and division sheets.

## INSURANCE.

This account includes all premiums made or paid by a carrier to its insurance fund and premiums (except reinsurance premiums) paid by it to insurance companies for insuring property or persons against loss, damage, or injury by fire, accident, or other causes when such loss, damage, or injury would otherwise be chargeable to "Traffic Expenses."

**NOTE A.**—The premiums paid by a carrier to its insurance fund should be credited on its books to an "Insurance Fund" account.

to which the amount of all claims for damages to the property covered by its insurance should be charged. To such account should be charged all reinsurance premiums paid insurance companies, and to it should be credited all amounts recovered from insurance companies for damage to property reinsured by them.

NOTE B. Appropriations made by a carrier to its insurance fund through Income Account should be credited directly to its "Insurance Fund" account.

#### OTHER EXPENSES.

This account includes all expenses in connection with traffic expenses not properly chargeable to other "Traffic Expenses" accounts.

### IV. TRANSPORTATION EXPENSES.

#### SUPERINTENDENCE.

This account includes:

**PAY OF OFFICERS.** Pay of vice-president and assistant, general manager and assistant when directly in charge of transportation, director of operation, manager of transportation, general superintendent of transportation, superintendent of transportation, general superintendent, superintendent, division and assistant superintendent, superintendent of car service, lost-car agent, train master, assistant train master, road foreman of locomotives, traveling locomotive engineer, traveling locomotive fireman, members of examining boards, superintendent of mail service, traveling train and station inspectors, air-brake instructor, superintendent of transfer stations, and other officers engaged exclusively in the transportation department.

**PAY OF CLERKS AND ATTENDANTS.**—Pay of chief and other clerks in offices and porters and attendants in offices and on special cars of officers whose pay is charged to this account.

**OFFICE AND OTHER EXPENSES.**—Rent and cost of repairing rented offices; telephone service, telegraph messages, and cost of heat, light, ice, water, furniture, and supplies (except stationery and printing), such as atlases, dictionaries, directories, maps, and periodicals for offices of officers whose pay is charged to this account; incidental office and traveling expenses of such officers and their clerks; cost of provisions for and expenses of special cars when used by them and cost of running special trains for officials mentioned;

also premiums on fidelity bonds of such officers and their assistants.

*Note.* When officers and others above mentioned are superintending other departments, also their salaries and expenses should be contracted and apportioned between the departments in which they are employed.

#### DISPATCHING TRAINS

This account includes pay of chief train dispatchers, their clerks and attendants; pay and expenses of train dispatchers and their operating operators and all incidental office expenses; pay and expenses of operators on lines whose duties are confined exclusively to train movement.

#### STATION EMPLOYEES

This account includes

**AGENTS, CLERKS AND ATTENDANTS.** Pay of freight and ticket agents in charge of stations, docks, wharves, and piers; chief agents, assistant agents, express or life, depot or station masters, assistant depot or station masters, station passenger and baggage agents, conductors, station attendants, clerks, telephone and telegraph operators at stations, car clerks, messengers, collectors, ticket examiners, ticket receivers, and ticket collectors at stations but not ticket receivers or collectors at trains; station foremen, train callers, directing passengers on trains, station baggage-men, porters, porters, others, station gate-men but not crossing gate-men, employees in information bureaus, package and parcel rooms, stations, mails, policemen, watchmen, and detectives, also payments for time of station inspectors at stations.

**LABOR AT STATIONS.** Pay of caremen, men, roughhouse foremen, rough millers, freight loaders and unloaders, call men, deliverymen, car rollers, weighmasters, trackmen, scudmen, copers, station cleaners, dockmen, handlers, teamsters, stevedores, longshoremen, employees at railroad terminals, engine-men for stationary engines, operating station heating and lighting plants or elevators in passenger or freight stations or operating freight carriers on docks, wharves, and piers to convey freight, employees attending electric lights, carrying and weighing mail at stations, transferring freight at stations for whatever reason, picking up, straightening, and rebanding lumber and other shipments on cars, weighing, loading, unloading, feeding, and watering stock, labor at stock yards other than repairs, ordinary cleaning of station grounds performed by station cleaners, removing snow

and fee from station platforms, walks, and stock yards and discharging at stations and stock yards.

**NOTE.** This account should not include the pay or expense of telegraph and telephone operators provided for under accounts "Dispatching, Train," and "Telegraph and Telephone Operations," or pay or expense of employees provided for under accounts "Stock Yards and Grain Elevators," and "Coal and Ore Docks," or those engaged in "Outside Operations."

#### WEIGHING AND CAR SERVICE ASSOCIATIONS

This account includes expense of weighing and inspection bureaus and car service associations.

#### STOCK YARDS AND GRAIN ELEVATORS

This account includes pay of employees and cost of supplies and all other expenses incurred in operating stock yards or grain elevators, which are not operated as "Outside Operations."

#### COAL AND ORE DOCKS

This account includes pay of employees and cost of supplies and all other expenses incurred in operating coal and ore docks, which are not operated as "Outside Operations."

#### STATION SUPPLIES AND EXPENSES

This account includes:

**HEATING.** Cost of fuel, water, steam, and supplies used in heating stations, waiting rooms, freight and passenger offices, and other station buildings.

**LIGHTING.** Cost of, or payment for, lighting streets and stations, gas and electric current, candles, incandescent lamps, and other supplies used in lighting stations, waiting rooms, freight and passenger offices, and other station buildings and street approaches thereto.

**OTHER EXPENSES.** Rent of station buildings; cost of furniture and renewal and repairs thereof; telephone service; express charges; supplies; hand implements for handling freight and baggage at stations; power for freight and passenger elevators; oil and wicking used in lanterns of watchmen (except track watchmen) or other employees in or about stations; uniforms, uniform trimmings and badges for station employees; material used at stations for packing freight; payments for transferring mail, horses and vehicles for station use; livery, and shoeing horses; feed and water for stock when carrier is responsible; payments to warehouse companies for storage of freight; cleaning privy vaults.

Payments for water, washing towels, sprinkling about stations; rents for use of automatic weighing and recording attachments for scales; also premiums on fidelity bonds of agents and other station employees, and those covering merchandise transported; licenses for ticket agents, agents' expenses, reports of commercial standing, and membership fees in agents' associations.

The following is a list of the more important articles chargeable to this account:

Atlases,	Gang planks,	Nails,
Awnings,	Gas,	Pinch bars,
Axes,	Hampers,	Rakes,
Baggage checks,	Harness,	Reflectors,
Barometers,	Hatchets,	Rolling chairs for baggage,
Baskets,	Hoes,	bids,
Bicycles,	Hooks,	Rubber hose,
Blocking,	Horses,	Safes,
Brooms,	Hose,	Sawdust,
Brushes,	Hose couplings,	Saws,
Buckets,	Ice,	Scoops,
Bulletin boards,	Ice barrels,	Seales, portable,
Call bells,	Ice boxes,	Scrubbing brushes,
Candles,	Ice buckets,	Settees,
Carpets,	Ice carts,	Shovels,
Car seal presses,	Ice tongs,	Sledges,
Chains,	Keys,	Soap,
Chairs,	Ladders for cleaning and lighting,	Spades,
Chair cushions,	Lampblack,	Sponges,
Chalk,	Lamp burners,	Sprinkling cans,
Chamois skins,	Lamp chimneys,	Stools,
Check boxes,	Lamp fittings,	Stove blacking,
Check racks,	Lamp globes,	Stoves and stovepipe,
City directories,	Lamp mantels,	Tables,
Clocks,	Lamps, not permanently attached to buildings,	Tacks,
Cold chisels,	Lanterns,	Tarpaulins (not for cars),
Copy-press stands,	Lantern fittings,	Thermometers,
Counter brushes,	Lantern globes,	Ticket cases,
Counter scales,	Letter boxes,	Tongs,
Cups,	Mall bags,	Tool boxes,
Curtains,	Maps and cases,	Torpedoes,
Cuspidors,	Marking brushes,	Towels,
Desks,	Marking pots,	Trucks,
Dippers,	Marline,	Twine,
Dusters,	Matches,	Typewriter stands,
Electric fans,	Measures,	Wagons,
Electric lamps, incandescent,	Medical boxes,	Wash basins,
Electric-light supplies,	Mirrors,	Waste,
Extinguishers, hand,	Money drawers,	Water barrels,
Feather dusters,	Nails for boxing,	Water bowls,
Files, document,	Newspapers,	Water cans,
Fire buckets,	Oil,	Water coolers,
Flags,	Oil cans,	Water pails,
Floor coverings,	Padlocks,	Wheelbarrows,
		Whisk brooms,
		Wrenches.



## YARDMASTERS AND THEIR CLERKS.

This account includes pay of general yardmaster, yardmaster, assistant yardmaster, general yard foreman, their clerks and attendants, and of employees engaged in calling yardmen, passenger and freight trainmen; also policemen, watchmen, and detectives in yard service.

NOTE.—This account and the following nine accounts, "Yard Conductors and Brakemen," "Yard Switch and Signal Tenders," "Yard Supplies and Expenses," "Yard Enginemen," "Engine-house Expenses—Yard," "Fuel for Yard Locomotives," "Water for Yard Locomotives," "Lubricants for Yard Locomotives," and "Other Supplies for Yard Locomotives," refer only to yards where regular switching service is maintained.

## YARD CONDUCTORS AND BRAKEMEN.

This account includes pay of yard conductors or yard foremen and yard brakemen or yard switchmen engaged in passenger and freight yard and terminal switching service.

## YARD SWITCH AND SIGNAL TENDERS.

This account includes pay of employees engaged in operating signals and interlocking plants in yards used exclusively for the government of the movement of yard trains; such as switch tenders, signalmen (other than telegraph operators), levermen, battymen, stationary engineers and firemen operating air compressors furnishing power for signals, lampmen, lamp cleaners, and lamplighters.

## YARD SUPPLIES AND EXPENSES.

This account includes expenses of employees named under account, "Yardmasters and their Clerks," cost of heating and lighting their offices and other supplies furnished therefor. Supplies furnished yard conductors and brakemen, supplies for all switch lights and for interlocking plants or other signal appliances at terminals; oil, wicks, etc., for switch lamps, semaphore lamps, or other signals and lanterns; flags, switch ropes and chains, and other supplies furnished employees whose wages are charged to accounts, "Yardmasters and their Clerks," "Yard Conductors and Brakemen," and "Yard Switch and Signal Tenders;" payments for lighting yards, fuel and supplies for heating and lighting yard interlocking or other signal towers, and switch tenders' houses; also other similar items.

## YARD ENGINEMEN.

This account includes pay of engineers and firemen engaged in passenger and freight, yard and terminal switching and transfer service.

## ENGINEHOUSE EXPENSES—YARD.

This account includes pay of, and cost of supplies furnished to, callers, watchmen, and other employees engaged in wiping, cleaning, firing up, dumping, boiler washing, cleaning fire boxes, watching, and dispatching locomotives; and of other enginehouse employees, such as tool checkers, enginehouse cleaners, cinder pit cleaners, clinker dumpers, truck packers, turntable operators, sand dryers, inspectors of smokestacks and ash pans, when engaged in caring for locomotives in yard or terminal service; also a proportion of wages paid enginehouse foremen and their clerks.

Some of the more important items chargeable to this account are: Boiled oil, lampblack, rags, waste, lye, cleaning and polishing compounds, tools for truck packers and hostlers, signal lights on turntables and transfer tables at enginehouses, expenses of operation of such tables by power; heating and lighting enginehouses and offices in them; oil for lubricating turntables; shovels, wheelbarrows, and other tools for cleaning around enginehouses and handling cinders; rent of cinder cars used at cinder pits; hose and water for cinder pits and for washing out boilers, cupboards in enginehouses, mechanical blowers and fire lighters for starting locomotive fires.

NOTE.—When enginehouse expenses are incurred jointly for yard and road locomotives they should be apportioned on basis of number of locomotives of each class handled.

## FUEL FOR YARD LOCOMOTIVES.

This account includes cost at point of issue of coal, coke, oil, wood, and other fuel issued to yard locomotives. It includes cost of loading into tenders, proportion of pay of fuel agents and clerks engaged in accounting for fuel at fuel stations, and cost of wheelbarrows, shovels, scoops, picks, and other tools used thereat.

NOTE.—Repairs and renewals of coal chutes, buggies, air hoists, pockets, screens, etc., should be charged to account "Buildings, Fixtures, and Grounds."

#### WATER FOR YARD LOCOMOTIVES.

This account includes the cost of water furnished yard locomotives, including the cost of labor and material consumed in operating, heating, and lighting water stations; gasoline, oil, waste, gasoline-engine batteries, thaw-out hose, rubber packing, siphons for water cars and locomotives, iron barrels for storing gasoline, stoves, stove furniture, coal, chemicals, and other compounds injected into locomotive boilers to decrease scale formations on boiler tubes; operating water purifying plants, tools, and other supplies (when not chargeable to account "Roadway Tools and Supplies"); also such items as breaking ice in water tanks, thawing out tank spouts and water cars, keeping fires in tanks and water cars to prevent freezing, shoveling snow in locomotive tenders, temporary connections between water cars and locomotive tenders; also amounts paid for water furnished for locomotives, including rent of ponds, lakes, sluices, or other sources of water supply for this purpose, and right of way for pipe lines.

*NOTE.* -- The apportionment of water as between yard and road locomotives should be on the basis of the relative number of tender tanks taken.

#### LUBRICANTS FOR YARD LOCOMOTIVES.

This account includes the cost of valve, engine, and car oil, grease, waste, and compounds for the lubrication of locomotives in yard service.

#### OTHER SUPPLIES FOR YARD LOCOMOTIVES.

This account includes the cost of headlight and signal oil and wicks used in headlights, signal lights, and enginemen's torches; supplies for electric-light dynamos and carbide for acetylene gas for lights on locomotives in yard service; also the cost of furniture, tools, and other movable articles and supplies required fully to equip yard locomotives for service.

The following are some of the items chargeable to this account, when furnished for use of yard engineering:

Ash hoes,	Hose (not air brake, air	Scrap,
Ash pan rods,	signal, or steam),	Shovels,
Axes,	Hose reels,	Slash bars,
Bars, buggy,	Jacks,	Sledges,
Bell cords,	Jackscrews,	Soap,
Boxes (portable),	Lamps (signal only),	Switch chains,
Brooms,	Lanterns and parts,	Switch ropes,
Brushes,	Locks for portable boxes,	Switch poles,
Buckets,	Matches,	Thaw-out hose,
Chimneys, headlights,	Metallic packing,	Tool boxes (portable),
Chisels,	Oil,	Torches,
Clinker hooks,	Oil cans,	Torpedoes,
Crowbars,	Packing hooks,	Water buckets,
Files,	Packing spoons,	Water coolers,
Flags,	Picks,	Wrecking frogs,
Grate shakers,	Pinch bars,	Wrenches,
Hammers,	Plugging bars,	
Handsaws,	Pokers,	
Hatchets,	Saws,	

NOTE.—For cost of sand, see account "Other Supplies for Road Locomotives."

#### OPERATING JOINT YARDS AND TERMINALS—DR.

This account includes a carrier's proportions of costs incurred to operate joint yards, terminals, and other facilities (except joint tracks) operated by other companies.

NOTE.—The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of operating joint yards and terminals operated by other companies, but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor and such distribution should be adhered to by the debtor.

#### OPERATING JOINT YARDS AND TERMINALS—CR.

This account includes the proportion of costs to operate joint yards, terminals, and other facilities (except joint tracks) operated by a carrier, chargeable to other companies.

NOTE.—The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of operating joint yards and terminals

operated by a carrier, but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

#### MOTORMEN.

This account includes pay of motormen while engaged in running electric locomotives or cars (except those engaged in work-train service) or while deadheading in connection therewith; also pay and expenses of motormen engaged in piloting electric trains or cars over home lines.

#### ROAD ENGINEMEN.

This account includes pay of engineers and firemen while engaged in revenue-train service or while deadheading in connection therewith.

NOTE. Pay of engineers and firemen on locomotives engaged in work-train service should be charged as a part of the work on which engaged.

#### ENGINEHOUSE EXPENSES. ROAD.

This account includes pay of and supplies furnished to callers, watchmen, and other employees engaged in wiping, cleaning, firing up, dumping, boiler washing, cleaning fire boxes, watching, and dispatching locomotives; and of other enginehouse employees, such as tool checkers, enginehouse cleaners, cinder pit cleaners, clinker dumpers, truck packers, turntable operators, sand dryers, inspectors of smokestacks and ashpans, when engaged in caring for locomotives in road service; also a proportion of wages paid enginehouse foremen and their clerks.

Some of the more important items chargeable to this account are: Boiled oil, lampblack, rags, waste, lye, cleaning and polishing compounds, tools for truck packers and hostlers, signal lights on turntables and transfer tables at enginehouses, expense of operation of such tables by power, heating, and lighting enginehouses and offices in them, oil for lubricating turntables, shovels, wheelbarrows, and other tools for cleaning around enginehouses and handling cinders; rent of cinder cars used at cinder pits; hose and water for cinder pits and for washing out boilers; cupboards in engine-

houses, mechanical blowers and fire lighters for starting locomotive fires.

NOTE A.—When enginehouse expenses are incurred jointly for yard and road locomotives, they should be apportioned on basis of number of locomotives handled.

NOTE B.—Cost of enginehouse expenses on locomotives engaged in work-train service should be charged as a part of the work on which engaged.

### FUEL FOR ROAD LOCOMOTIVES.

This account includes cost at point of issue of coal, coke, oil, wood, and other fuel issued to road locomotives. It includes cost of loading into tenders, proportion of pay of fuel agents and clerks engaged in accounting for fuel at fuel stations, and cost of wheelbarrows, shovels, scoops, picks, and other tools used thereat.

NOTE A.—Repairs and renewals of coal chutes, hugges, air holds, pockets, screens, etc., should be charged to account, "Buildings, Fixtures, and Grounds."

NOTE B.—Cost of fuel issued to locomotives engaged in work-train service should be charged as a part of the work on which engaged.

### WATER FOR ROAD LOCOMOTIVES

This account includes the cost of water furnished road locomotives, including the cost of labor and material consumed in operating, heating, and lighting water stations; gasoline, oil, waste, gasoline-engine batteries, thaw-out hose, rubber packing, siphons for water cars and locomotives, iron barrels for storing gasoline, stoves, stove furniture, coal, chemicals, and other compounds injected into locomotive boilers to decrease scale formations on boiler tubes; operating water-purifying plants, tools, and other supplies (when not chargeable to account "Roadway Tools and Supplies"); also such items as breaking ice in water tanks, thawing out tank spouts and water cars, keeping fires in tanks and water cars to prevent freezing, shoveling snow in locomotive tenders, temporary connections between water cars and locomotive tenders; also amounts paid for water furnished for locomotives, including rent of ponds, lakes, sluices, or other sources of water supply for this purpose, and right of way for pipe lines.

NOTE A.—The apportionment of water as between yard and road locomotives should be on the basis of the relative number of tender tanks taken.

NOTE B.—Cost of water and expenses of water supply for locomotives engaged in work-train service should be charged as a part of the work on which engaged.

## LUBRICANTS FOR ROAD LOCOMOTIVES.

This account includes the cost of valve, engine, and car oil, grease, waste, and compounds for the lubrication of locomotives in road service.

NOTE. Cost of lubricants for locomotives engaged in work-train service should be charged as a part of the work on which engaged.

## OTHER SUPPLIES FOR ROAD LOCOMOTIVES.

This account includes the cost of headlight and signal oil and wicks used in headlights, signal lights, and engine-men's torches; supplies for electric light dynamo and carbide for acetylene gas for lights on locomotives in road service; also the cost of furniture, tools, and other movable articles and supplies required fully to equip road locomotives for service; fuel for sand dryers and cost of sand and of loading it at sand pits; wheelbarrows, shovels, and sand screens used in handling sand for road locomotives.

The following are some of the more important items chargeable to this account:

Ash hoes,	Hose (not air brake air signal, or steam),	Saws,
Ash-pan rods,	Hose reels,	Scoops,
Axes,	Jacks,	Shovels,
Bars, buggy,	Jackscrows,	Slash bars,
Bell cords,	Lamps (signal only),	Sledges,
Boxes (portable),	Lanterns and parts,	Soap,
Brooms,	Locks for portable boxes,	Switch chains,
Brushes,	Matches,	Switch ropes,
Buckets,	Metallic packing,	Switch poles,
Chimneys (headlight),	Oilers,	Thaw-out hose,
Chisels,	Oil cans,	Tool boxes (portable),
Choker hooks,	Packing hooks,	Torches,
Crowbars,	Packing spoons,	Torpedoes,
Files,	Picks,	Water buckets,
Flags,	Pinch bars,	Water coolers,
Grate shakers,	Plugging bars,	Wrecking frogs,
Hammers,	Pokers,	Wrenches.
Handsaws,	Sand,	
Hatchets,		

NOTE A.—Cost of other supplies for locomotives engaged in work-train service should be charged as a part of the work on which engaged.

NOTE B.—The cost of sand as between yard and road locomotives being undeterminable, the entire cost of sand issued to all locomotives should be charged to this account.

## OPERATING POWER PLANTS.

This account includes:

**PAY.**—Pay of employees engaged in operating electric power stations and substations, including engine rooms, boiler houses, dynamo or power houses, etc., such as engineers, firemen, electricians, dynamomen, oilers, cleaners, coal passers, and other employees, except those engaged in making repairs and renewals.

**FUEL.**—All expenditures for coal, oil, or gas used as fuel, or other fuel, including freight or other delivery charges, if any, and labor unloading or stocking.

**WATER.**—Cost of water used to produce steam, or to operate a water-power plant, including pumping, rent of ponds, streams, and pipe lines.

**OTHER SUPPLIES AND EXPENSES.**—Cost of lubricants, oil, waste, grease, etc., used on engines, shafting, dynamos, and pumps; also carbon brushes, fuses, lamps, and other supplies, heat, light, and other expenses not elsewhere specified.

## PURCHASED POWER.

This account includes all payments for power purchased for the propulsion of electric locomotives, trains, or cars.

## ROAD TRAINMEN.

This account includes the pay of train auditors, conductors, baggagemen, brakemen, flagmen, train porters (except on cars used in nonrevenue service), train guards, water carriers, and other trainmen while engaged in revenue train service, or deadheading in connection therewith; also pay of pilots engaged in piloting trains over home lines.

**NOTE.**—Pay of trainmen engaged in work-train service should be charged as a part of the work on which engaged.

## TRAIN SUPPLIES AND EXPENSES.

This account includes:

**CLEANING CARS.**—Pay of car cleaners; also employees engaged in scrubbing the outside of cars at car-cleaning or station yards; cost of hose for washing cars, steam hose, and fuel for heating water for washing cars, water used for cleaning cars, compressed air for cleaning cushions and car



seats; brooms, brushes, soap, modoc and other liquids, sponges, and all other material for cleaning and disinfecting cars.

**HEATING CARS.**—Pay of employees engaged in handling coal for heating cars and removing ashes from stoves in cars; stoves and heaters for temporary use in freight cars; cost of hose and loose or movable articles connected with heating plants at stations used for supplying heat to cars; fuel, steam, or other heating material; expenses of boiler plants used for supplying heat to cars at stations and yards.

**LIGHTING CARS.**—Pay of employees engaged in filling and cleaning lamps for lighting cars; cost of supplying or pumping gas into cars and hose used in connection therewith; gas, electric current, oil, candles, wicks, globes, shades, chimneys, and all other supplies used in lighting cars; supplies and fuel for gas-pumping plants, gas-pump engines, gas pumps, carburetors, and filling cans for carburetors.

**LUBRICATING CARS.**—Pay of car oilers; also employees engaged in distributing supplies for lubricating cars; cost of tools, such as packing hooks and irons, dope buckets, oil, grease, waste, wool, and other supplies used in lubricating cars.

**ICING AND WATERING CARS.**—Pay of employees engaged in icing and watering cars; cost of ice, water, and tools, such as buckets, ladders, and hose used in icing and watering cars; also cost of refrigeration when borne by the carrier.

**DETOURING TRAINS.**—Cost of temporary use of tracks of other companies, including the cost of pilot service, on account of wrecks, washouts, landslides, snow blockades, and other defects of tracks, bridges, or tunnels.

**OTHER EXPENSES.**—Pay of attendants keeping, and cost of supplies furnished, bunk rooms for engineers, firemen, and trainmen; contributions to Y. M. C. A. and similar organizations, including pay of superintendents and secretaries of reading rooms; cost of oil and wicking for train signal lamps and for lanterns of trainmen (except work trainmen), waste for cleaning lamps and lanterns, and pay of employees engaged exclusively in cleaning, trimming, and filling them; cost of miscellaneous supplies furnished cars for the purpose of protection against accidents and fires; provisions, supplies, or board for passengers, or feed for live stock on snow-bound trains or trains delayed by other causes; cost of bedding for

stock cars, dunnage furnished cars, chains for securing loads, temporary grain doors, temporary lining of freight cars for carrying freight otherwise liable to injury, planking cars for shipments of billets and other material, boards for flooring fruit cars, boards and slats to fit box and stock cars for carrying coal, coke, and other freight; safety chains for holding together twin and triple cars; opening ends of cars for shipment of rails and structural material; transferring passengers, express matter, baggage, mail, and freight on account of defective tracks, bridges, or tunnels; premiums on fidelity bonds of trainmen; cost of apparatus for testing sight and hearing of engineers, firemen, and trainmen; uniforms, uniform trimmings, and badges for trainmen; laundry work for cars; also cost of miscellaneous supplies required fully to equip revenue trains for service.

The following is a list of the more important articles chargeable to this account:

Axes,	Ice,	Signs on cabooses,
Beds, bed linen, and blankets,	Jacks,	Sledges,
Bell cords (renewals),	Jackscrews,	Soap,
Brooms,	Lamp boards,	Straw and sawdust,
Brushes,	Lantern fixtures,	Switch chains,
Bull's-eyes,	Lanterns,	Switch ropes,
Candles,	Lumber for dunnage,	Tin boxes for trainmen,
Chains,	Matches,	Torpedoes,
Chimneys,	Medical boxes,	Towels,
Cold chisels,	Notices,	Trainmen's lanterns,
Conductors' punches,	Oil cans,	Train signal lamps,
Cuspidors,	Order hoops,	Train tool boxes,
Disinfecting machines, portable,	Packing hooks,	Tumblers,
Fire buckets,	Pa flocks and custom locks on cars,	Ventilator and lamp sticks,
Flags,	Pails,	Water buckets,
Fusees,	Punches,	Water coolers,
Grease buckets,	Saws,	Wrecking frogs,
Hammers,	Scoops,	Wrenches,
Hatchets,	Shovels,	
	Signal boxes,	

#### INTERLOCKERS, BLOCK AND OTHER SIGNALS—OPERATION.

This account includes pay of employees engaged in operating signals and interlocking plants (other than those exclusively used for the government of the movement of yard locomotives and trains), such as switch tenders, signalmen (other than telegraph operators), levermen, batterymen, stationary

engineers and firemen operating air compressors used in connection with signals; lampmen, lamp cleaners, and lamp-lighters; cost of supplies used in operating signals and cost of fuel, water, light, furniture, and supplies for signal offices.

NOTE.—Pay of employees engaged exclusively in operating yard signal and interlocker plants should be charged to account "Yard Switch and Signal Tenders."

#### CROSSING FLAGMEN AND GATEMEN.

This account includes pay of street and highway crossing gate keepers and flagmen and cost of supplies used by them.

#### DRAWBRIDGE OPERATION.

This account includes all labor expended in the operation of drawbridges, such as pay of bridge tenders, engineers of stationary engines turning drawbridges, watchmen, etc.; also cost of supplies such as fuel, oil, lanterns, water, waste, boats, stoves, chairs, brooms, pails, etc.

#### CLEARING WRECKS.

This account includes all expenses of clearing wrecks (except wrecks of work trains, which should be charged to the work on which the train was engaged); cost of material used and labor expended in replacing wrecked equipment upon the tracks, and the attendant expenses of the wrecking trains and wrecking tools used in such work; cost of labor building temporary tracks around wrecks and removing such tracks; payments for reloading or transferring freight, passengers, express, baggage, and mail; provisions or board for men clearing up or watching at wrecks.

TRAIN SERVICE.—Pay of train engineers, trainmen, and enginehousemen; cost of fuel, stores, and other supplies for train locomotives and cars; cost of oil and wicking used in lanterns of train engineers and trainmen while such employees and equipment are engaged in clearing wrecks.

NOTE.—The cost of restoring roadbed and tracks to original condition and the cost of repairing and renewing equipment damaged or destroyed in wrecks should be charged to the proper "Maintenance of Way and Structures" and "Maintenance of Equipment" accounts.

#### TELEGRAPH AND TELEPHONE—OPERATION.

This account includes:

OPERATORS AND MESSENGERS.—Pay of telegraph operators and messengers in telegraph and relay offices other than those

employed in dispatching trains and those located at stations who also perform other station work.

**TELEPHONES.**—Pay of operators and messengers; cost of chemicals, coppers, zines, and other supplies for charging telephone batteries; costs incident to the use of telephone cable lines and conduits, and telephone rents and expenses not otherwise provided for.

**OTHER EXPENSES.**—Pay and expenses of superintendent of telegraph, his clerks and attendants, and incidental office expenses; pay and expenses of telegraph censor; cost of chemicals, coppers, zines, and other supplies for charging telegraph batteries; rent, fuel, light, furniture, and other supplies for telegraph offices; bicycles for messengers; excess payments to telegraph companies; costs incident to rent of telegraph conduits, telegraph lines, and telegraph poles of other companies.

**NOTE.**—The salaries and expenses of superintendents and assistant superintendents of telegraph when engaged in both maintaining and operating telegraph and telephone lines should be charged 50 per cent to account "Telegraph and Telephone Lines" and 50 per cent to account "Telegraph and Telephone Operation."

#### OPERATING FLOATING EQUIPMENT.

This account includes, when not chargeable to "Outside Operations:"

**STEAMBOATS AND TUGBOATS—SUPERINTENDENCE AND MANNING.**—Pay of ferry superintendent, his clerks and attendants, ferry station master, ferry agents, passenger and vehicle ticket sellers, and collectors, bridgemen, gatemen, cleaners, and storekeepers at ferries, and all employees on ferryboats, steamboats, power launches, steam lighters, and tugboats; proportion of pay of lighter master, his clerks and attendants; premiums on fidelity bonds of such employees.

**STEAMBOATS AND TUGBOATS—CHARTERS.**—Cost of chartering ferryboats, steamboats, power launches, steam lighters, and tugboats; and payments for towage.

**STEAMBOATS AND TUGBOATS—INCIDENTALS.**—Cost of ropes, mops, brooms, soap, brushes, dusters, pails, hose, globes, wicks, water, gas, oil, tallow, grease, waste, lamps, flags, ice, planks, axes, shovels, trucks, handspikes, and other supplies and tools for ferryboats, steamboats, power launches, power lighters, and tugboats; pumping out boats laid up; raising

sunken boats; removing ashes from boats; removing ice from around ferry bridge pontoons; transferring passengers in case of accident; inspecting; electric and other lighting on boats and at ferries; expenses for wharfage; payments of custom-house or license fees and for damage to vessels and wharves of others by collision or otherwise; and other expenses of similar nature.

**BARGES, CAR FLOATS, AND CANAL BOATS—SUPERINTENDENCE AND MANNING.**—Pay of employees on barges, car floats, canal boats, and lighters; and proportion of pay of lighter master, his clerks and attendants.

**BARGES, CAR FLOATS, AND CANAL BOATS—CHARTERS.**—Cost of chartering barges, car floats, canal boats, and lighters; and payments for lighterage.

**BARGES, CAR FLOATS, AND CANAL BOATS—INCIDENTALS.**—Cost of ropes, mops, brooms, soap, brushes, pails, hose, globes, wicks, oil, water, and other supplies for barges, car floats, canal boats, and lighters; removing cars or car trucks lost overboard from floats; inspecting; pumping out boats laid up; raising sunken boats; transferring cargoes in case of accident; expenses for wharfage; payments of custom-house and license fees and for damage to vessels and wharves of others by collision or otherwise; and other expenses of similar nature.

The following is a list of the more important articles chargeable to this account:

Axes,	Ice,	Tablecloths,
Bed linen and blankets,	Lamps,	Tableware,
Commissary supplies,	Laundry,	Tallow,
Cooking utensils,	Lines,	Trucks,
Flags,	Oil,	Waste,
Grease,	Oilers,	Water,
Handspikes and other tools,	Planks,	Wool,
Hatchets,	Provisions,	Wrenches
Hose for cleaning,	Shovels,	
	Stores,	

**FUEL.**—Cost of fuel used on steamboats, power launches, power lighters, ferryboats, and tugboats, including freight charges and expenses of delivering fuel on boats.

**ELEVATION AND LONGSHORE LABOR.**—Pay of bridgemen at transfer bridges, watchmen, longshoremen, and laborers employed at wharves, piers, and docks in loading and unloading lighterage freight, loading and discharging cargoes, and in operating steam or other power for same; payments for

power (not furnished by the company) used in loading and discharging cargoes; expenses incident to heating and lighting; cost of supplies not chargeable to account "Station Supplies and Expenses" used in connection with operating wharves, piers, and docks, and power and supplies for transfer or float bridges.

The following is a list of the more important articles used at float bridges and piers in connection with the float movement of freight exclusively, and supplies furnished float master's office, chargeable to this account:

Brooms,	Incandescent lights,	Shovels,
Carbons,	Lamps, reflector,	Soap,
Chalk,	Lanterns,	Tacks,
Coal hods,	Marline,	Tallow,
Coal shovels,	Matches,	Torches,
Cold chisels,	Oil,	Towels,
Crowbars,	Oil cans,	Twine,
Gas,	Pails,	Waste,
Hammers,	Pinch bars,	Water,
Hatchets,	Ropes,	Water coolers,
Ice,	Salt,	Wheelbarrows,
Ice tongs,	Scoops,	

NOTE.—Insurance recovered should be credited to this account.

## EXPRESS SERVICE.

This account includes, when not chargeable to "Outside Operations:"

**DRIVERS AND MESSENGERS.**—Pay of express messengers, drivers, and helpers; pay of baggagemasters handling express, and premiums on their fidelity bonds; cost of uniforms, uniform trimmings, and badges for express messengers, drivers, and helpers.

**HORSES AND HORSE KEEP.**—Pay of stablemen in express service; rent of stables; cost of replacing stock; and feeding and shoeing stock.

**WAGONS AND HARNESS.**—Cost of repairing and renewing wagons, harness, and automobiles used in express service.

## STATIONERY AND PRINTING.

This account includes the cost of stationery, stationery supplies, printing, books, and blank forms used in connection with transportation expenses. Dictionaries, periodicals, technical books, etc., should be charged to account "Superintendence."

The following is a list of the more important items chargeable to this account.

Adding machines,	Eyelets,	Postage,
Addressographs and supplies,	Forms,	Printed cards,
Arm rests,	Fuel tickets,	Printed tablets,
Baggage checks, printed,	Glass pens,	Profile books, and paper,
Bills of lading,	Hektographs,	Punches (not conductors' or baggagemen's),
Binders,	Indexes,	Rubber bands,
Blank books,	Ink, for writing and drawing,	Rubber stamps,
Blank cards,	Inkstands,	Rulers,
Blank forms,	Invoice books,	Ruling pens,
Blank paper,	Legal-cap paper,	Scrapbooks,
Blank tablets,	Letter paper,	Sealing wax,
Blotters,	Manifold paper,	Seals,
Blotting paper,	Manifold pens,	Shears,
Blue print paper,	Mimeographs,	Shipping tags,
Books for field notes,	Mucilage,	Shorthand notebooks,
Bristol board,	Mucilage brushes,	Sponges,
Calculating machines,	Neostyles,	Sponge cups,
Calendars,	Note paper,	Stamps, impression,
Caligraphs,	Notices,	Stylographs,
Carbon paper,	Numbering stamps,	Tablets,
Cardboard,	Oil paper,	Tape,
Cards,	Orders,	Telegraph blanks,
Circulars,	Paper,	Tickets,
Computing tables,	Paper baskets,	Ticket stamps,
Copy (impression) books,	Paper clips,	Time-tables,
Copying brushes,	Paper cutters,	Tissue (impression) paper,
Copying presses,	Paper fasteners,	Tracing cloth,
Crayons,	Paper files,	Tracing paper,
Cross-section books,	Paper weights,	Twine,
Cross-section paper,	Papyrographs,	Typewriters and ribbons,
Cyclostyles,	Parchment paper,	Wage tables,
Dating stamps and ribbons,	Pencils, for writing and drawing,	Wastebaskets,
Drawing paper,	Pencil sharpeners,	Water colors,
Delivery tickets,	Penholders,	Water holders,
Duplicators,	Penracks,	Waybills,
Electric pens,	Pens, for writing and drawing,	Wrapping paper,
Envelopes,	Pins,	Wringers for copying presses,
Erasers, rubber and steel,		
Eyelet punches,		

## INSURANCE.

This account includes all premiums made or paid by a carrier to its insurance fund and premiums (except reinsurance premiums) paid by it to insurance companies for insuring property or persons against loss, damage, or injury by fire,

accident, or other causes, when such loss, damage, or injury would otherwise be chargeable to "Transportation Expenses."

NOTE A.—The premiums paid by a carrier to its insurance fund should be credited on its books to an "Insurance Fund" account, to which the amount of all claims for damages to the property covered by its insurance should be charged. To such account should be charged all reinsurance premiums paid insurance companies, and to it should be credited all amounts recovered from insurance companies for damage to property reinsured by them.

NOTE B.—Appropriations made by a carrier to its insurance fund through Income Account should be credited directly to its "Insurance Fund" account.

#### OTHER EXPENSES.

This account includes all expenses in connection with transportation not properly chargeable to other "Transportation Expenses" accounts.

#### LOSS AND DAMAGE—FREIGHT.

This account includes payments for loss, damage, delays, or destruction of freight, locomotives, or cars when waybilled as freight (but not including company's material), parcels, or express intrusted to a carrier for transportation, including live stock received for shipment, and all expenses directly incident thereto; freight in transit lost overboard from lighters (less insurance recovered and net amount received from sale of unclaimed and damaged freight); cost of repacking and boxing damaged merchandise and other property; pay and expenses of employees or others engaged as adjusters and in detecting thieves; and services and expenses of employees or others while engaged as witnesses in law suits in connection with loss and damage cases.

NOTE.—Expenses, not otherwise provided for, in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

#### LOSS AND DAMAGE—BAGGAGE.

This account includes payments for loss, damage, or destruction of baggage and other personal property, including clothing carried as baggage, damage to clothing worn by persons not in accident; and all expenses directly incident thereto, including services and expenses of employees or others while engaged as witnesses in law suits in connection with cases



involving loss or damage to baggage, less insurance recovered and net amount received from sale of unclaimed and damaged baggage.

NOTE.—Expenses, not otherwise provided for, in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of the final judgments, including plaintiffs' court costs, should be charged to this account.

#### DAMAGE TO PROPERTY.

This account includes payments for damages to or destruction of crops, buildings, lands, fences, vehicles, or any other property (except freight and baggage intrusted for transportation and except also stock as provided for under account "Damage to Stock on Right of Way"), whether occasioned by fire, collision, or otherwise, less insurance recovered. Payments for damages to locomotives or cars and the property therein of another company having trackage rights caused by collision of trains; and cost of repairing damage to another railway company's roadbed, track, or equipment, caused by collisions at grade crossings; detecting thieves, detaining vessels at drawbridges and payment of fines and costs on account of blocking street crossings; also pay and expenses of employees and other witnesses in suits.

NOTE A.—Expenses, not otherwise provided for, in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

NOTE B.—The pay and expenses of claim adjusters, clerks, and others, whose pay can not be actually allocated to any case, should be divided equally between personal injury and other claims over which they have jurisdiction.

#### DAMAGE TO STOCK ON RIGHT OF WAY.

This account includes payments for cattle and other live stock killed or injured while crossing or trespassing on the right of way; cost of removing and burying same; pay and expenses of stock claim agents; pay and expenses of employees and other witnesses in suits.

NOTE A.—Expenses, not otherwise provided for, in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

NOTE B.—The pay and expenses of claim adjusters, clerks, and others, whose pay can not be actually allocated to any case should be divided equally between personal injury and other claims over which they have jurisdiction.

## INJURIES TO PERSONS.

This account includes all expenses incident to injuries to persons when caused directly in connection with transportation; proportion of salaries and expenses of physicians and surgeons, expenses of undertakers, nursing and hospital attendance, medical and surgical supplies, artificial limbs, funeral expenses, railway and carriage fares for conveying injured persons and attendants; also proportion of pay and expenses of claim adjusters and their clerks, and pay and expenses of employees and others called in consultation in relation to the adjustment of claims coming under this head.

NOTE A.—Expenses not otherwise provided for in connection with the conduct of suits should be charged to account "Law Expenses," but the amount of final judgments, including plaintiffs' court costs, should be charged to this account.

NOTE B.—When contributions are made to hospitals, the total thereof should be distributed to the several "Injuries to Persons" accounts as follows: 25 per cent to "Maintenance of Way and Structures," 25 per cent to "Maintenance of Equipment," and 50 per cent to "Transportation Expenses."

NOTE C.—The pay and expenses of claim adjusters, clerks, and others whose pay can not be actually allocated to any case should be divided equally between personal injury and other claims over which they have jurisdiction.

## OPERATING JOINT TRACKS—DR.

This account includes a carrier's proportion of transportation expenses in the use of joint tracks operated by other companies.

NOTE.—The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of operating joint tracks operated by other companies but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

## OPERATING JOINT TRACKS—CR.

This account includes the proportion of transportation expenses for the use of joint tracks operated by a carrier chargeable to other companies.

NOTE.—The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of operating joint tracks operated by

a carrier but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

## V. GENERAL EXPENSES.

### SALARIES AND EXPENSES OF GENERAL OFFICERS.

This account includes:

**SALARIES.**—Pay of chairman of board, president, vice-president, assistant to the president, assistant to vice-president, treasurer, assistant treasurer, local treasurer, assistant to the treasurer, secretary, assistant secretaries, treasurers and secretaries of branch lines, registrar of stock, registrar of bonds, transfer agent, comptroller, assistant comptroller, assistant to the comptroller, general auditor, auditor, assistant auditor, and all subordinate officers of the accounting department, freight claim agent, assistant freight claim agent, general accountant, real estate agent, assistant real estate agent, and tax commissioner; and all other general officers not otherwise provided for; salaries and fees of receivers.

**EXPENSES.**—This account includes traveling and other expenses of officers named above, and supplies for special cars while used by them, and cost of running special trains for them; membership fees of general officers in railway and other associations.

**NOTE A.**—When an officer's duties are restricted to an individual department, his salary and expenses should be charged to the individual department under account "Superintendence" or account "Law Expenses."

**NOTE B.**—When officers and others, above enumerated, have supervision over other departments also, their salaries and expenses should be apportioned equally between the departments over which they have jurisdiction.

**NOTE C.**—The pay and expenses of purchasing agent, assistant purchasing agent, assistant to purchasing agent, general storekeeper, division storekeeper, and their clerks should be charged to "Material" account through clearing account "Store Expenses."

### SALARIES AND EXPENSES OF CLERKS AND ATTENDANTS.

This account includes:

**CLERKS.**—Pay of chief accountants, chief and other clerks of the officers specified in account "Salaries and Expenses of

General Officers," cashiers, paymasters and their clerks, traveling auditors, traveling accountants, special agents, inspectors and route agents of the accounting department, and postmaster, mail clerks, and assistants in general office.

**ATTENDANTS.** Pay of superintendent and assistant superintendent of general office building, bank messengers, ushers in general offices, pumpmen, watchmen, messengers, service-wagon drivers, stablemen, janitors, cleaners, elevator conductors, engineers and firemen of stationary engines, telephone operators and other employees in connection with general offices not provided for elsewhere; also pay of porters, cooks, etc., in general office buildings and on special cars while in use by general officers and general office employees.

**EXPENSES.** This account includes traveling and other expenses of employees named above and supplies for special cars while used by them; also cost of running special trains for them.

#### GENERAL OFFICE SUPPLIES AND EXPENSES.

This account includes rent, repairs of rented buildings and fixtures therein, alterations of partitions and fixtures; furniture, and all expenses and supplies incident to the heating, lighting, and care of general offices; cost of service automobiles, wagons, and harness, and expenses of repairing; cost of horses and horse keep, and of atlases, directories, and other books of reference for general office use; telephone service, express charges, telegraph and cable tolls; payments for local messenger service, subscriptions for newspapers and periodicals; premiums on fidelity bonds of general office employees.

#### LAW EXPENSES.

This account includes pay and expenses of vice-president and assistants when directly in charge of the law department, all counsel, solicitors, and attorneys, their clerks and attendants, and expenses of their offices; cost of law books, printing briefs, legal forms, testimony, reports, etc.; fees and retainers for service of attorneys not regular employees of a carrier; payments to arbitrators for the settlement of disputed questions; costs of suits and payments of special fees, notarial fees, and witness fees not provided for elsewhere; expenses connected with taking depositions, and all law and court expenses not provided for elsewhere.

## INSURANCE.

This account includes all premiums made or paid by a carrier to its insurance fund and premiums (except reinsurance premiums) paid by it to insurance companies, for insuring property or persons against loss, damage, or injury by fire, accident, or other causes, when such loss, damage, or injury would otherwise be chargeable to "General Expenses."

NOTE A. The premiums paid by a carrier to its insurance fund should be credited on its books to an "Insurance Fund" account, to which the amount of all claims for damages to the property covered by its insurance should be charged. To such account should be charged all reinsurance premiums paid insurance companies, and to it should be credited all amounts recovered from insurance companies for damage to property reinsured by them.

NOTE B. Appropriations made by a carrier to its insurance fund through Income Account should be credited directly to its "Insurance Fund" account.

## RELIEF DEPARTMENT EXPENSES.

This account includes all salaries and expenses incurred by a carrier company in connection with operating relief departments, also contributions made by a carrier to such department.

## PENSIONS.

This account includes all pensions paid to retired employees and expenses in connection therewith.

## STATIONERY AND PRINTING.

This account includes cost of printing annual reports, blank books, blank forms, contracts, leases, bonds, stock certificates, passes, also postage, paper, stationery, and stationery supplies used only in general offices and not chargeable to other accounts. It includes cost of all stationery and printing of the law department, except cost of printing briefs, legal forms, testimony, reports, etc.

The following is a list of the more important items chargeable to this account:

Adding machines,	Hektographs,	Printed cards,
Addressographs and supplies,	Indexes,	Printed tablets,
Arm rests	Ink, for writing and drawing,	Punches (not conductors' or baggage-men's),
Binders,	Inkstands,	Rubber bands,
Blank books,	Invoice books,	Rubber stamps,
Blank cards,	Legal-cap paper,	Rulers,
Blank forms,	Letter paper,	Ruling pens,
Blank paper,	Manifold paper,	Scrapbooks,
Blank tablets,	Manifold pens,	Sealing wax,
Blotters,	Mimeographs,	Seals,
Blotting paper,	Mucilage,	Shears,
Blue print paper,	Mucilage brushes,	Shipping tags,
Bristol board,	Neostyles,	Shorthand notebooks,
Calculating machines,	Note paper,	Sponge cups,
Calendars,	Notices,	Sponges,
Caligraphs,	Numbering stamps,	Stamps, impression,
Carbon paper,	Oil paper,	Stylographs,
Cardboard,	Orders,	Tablets,
Cards,	Paper,	Tape,
Circulars,	Paper baskets,	Telegraph blanks,
Computing tables,	Paper clips,	Tissue (impression) paper,
Copy (impression) books,	Paper cutters,	Tracing cloth,
Copying brushes,	Paper fasteners,	Tracing paper,
Copying presses,	Paper files,	Twine,
Crayons,	Paper weights,	Typewriters and ribbons,
Cyclostyles,	Papyrographs,	Wage tables,
Dating stamps and ribbons,	Parchment paper,	Wastebaskets,
Drawing paper,	Pencils, for writing and drawing,	Water colors,
Duplicators,	Pencil sharpeners,	Water holders,
Electric pens,	Penholders,	Wrapping paper,
Envelopes,	Penracks,	Wringers for copying presses,
Erasers, rubber and steel,	Pens, for writing and drawing,	
Eyelet punches,	Pins,	
Eyelets,	Postage,	
Forms,		
Glass pens,		

#### OTHER EXPENSES.

This account includes incidental expenses only—that is, such expenses in connection with "General Expenses" as are not properly chargeable to any of the foregoing accounts; cost of publishing notices of stockholders' meetings, of election of directors, annual reports in newspapers, of dividends declared, and of other corporate and financial notices of a general character; fees and expenses paid to directors; also contribution to funds on account of catastrophes, epidemics, etc.

# GENERAL ADMINISTRATION JOINT TRACKS, YARDS, AND TERMINALS—DR.

This account includes a carrier's proportion of "General Expenses" incident to maintaining and operating joint tracks, yards, terminals, and other facilities used jointly, operated by other companies.

NOTE.—The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of general administration of joint tracks, yards, and terminals administered by other companies but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

# GENERAL ADMINISTRATION JOINT TRACKS, YARDS, AND TERMINALS—CR.

This account includes the proportion of "General Expenses" incident to maintaining and operating joint tracks, yards, terminals, and other facilities used jointly, operated by a carrier, chargeable to other companies.

NOTE.—The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of general administration of joint tracks, yards, and terminals administered by a carrier but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

A true copy:

EDW. A. MOSELEY,

*Secretary.*

[L. S.]

\*





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EX. 6

SUPPLEMENT TO THE THIRD REVISED ISSUE

OF THE

CLASSIFICATION

OF

OPERATING EXPENSES

AS PRESCRIBED BY THE

INTERSTATE COMMERCE COMMISSION

FOR

STEAM ROADS

IN ACCORDANCE WITH

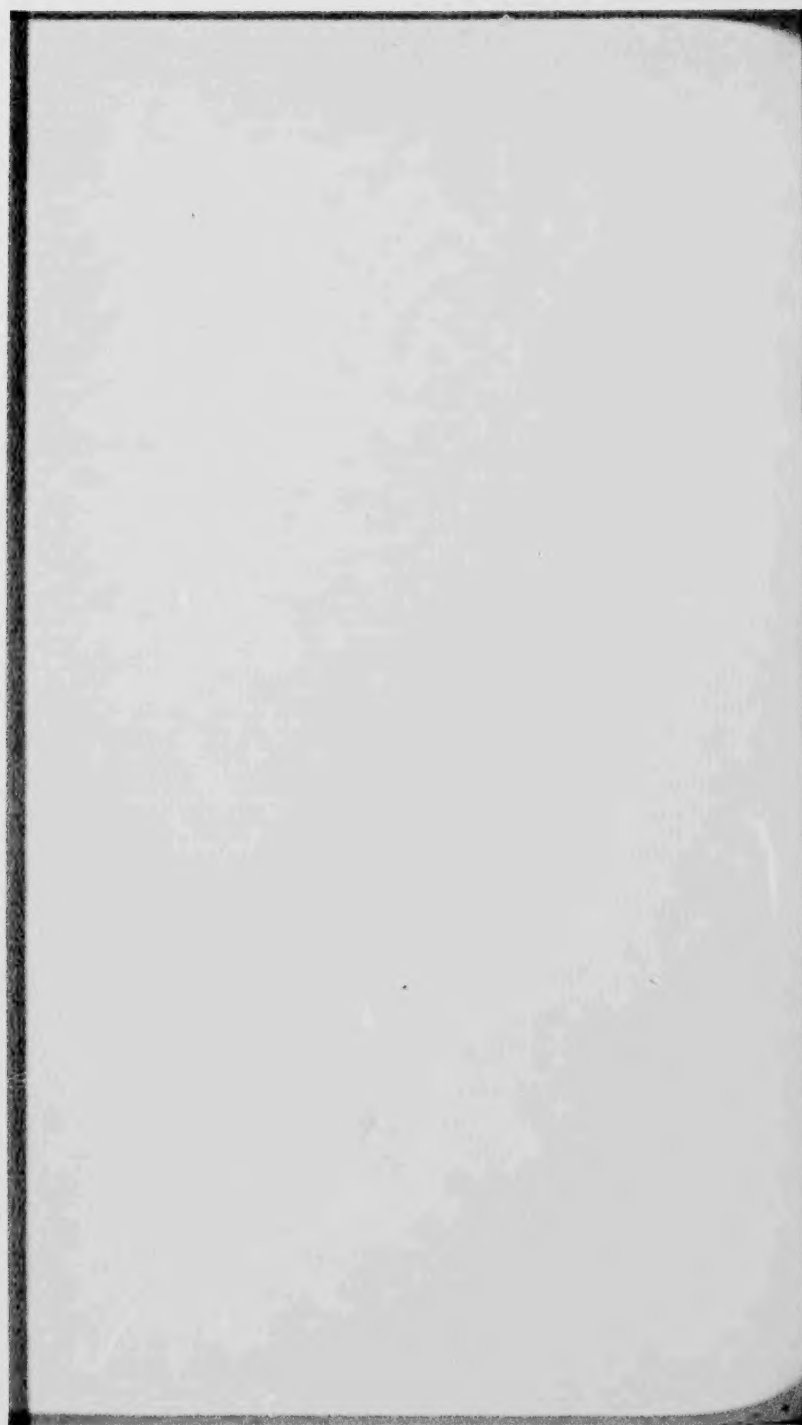
SECTION 20 OF THE ACT TO REGULATE  
COMMERCE

---

*Effective on July 1, 1908*

---

WASHINGTON  
GOVERNMENT PRINTING OFFICE  
1908



SUPPLEMENT TO THE THIRD REVISED ISSUE

OF THE

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OPERATING EXPENSES

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IN ACCORDANCE WITH

SECTION 20 OF THE ACT TO REGULATE  
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*Effective on July 1, 1908*

WASHINGTON

GOVERNMENT PRINTING OFFICE

1908



THE INTERSTATE COMMERCE COMMISSION.

---

MARTIN A. KNAPP, *of New York.*

JULSON C. CLEMENTS, *of Georgia.*

CHARLES A. PROUTY, *of Vermont.*

FRANCIS M. COCKRELL, *of Missouri.*

FRANKLIN K. LANE, *of California.*

EDGAR E. CLARK, *of Iowa.*

JAMES S. HARLAN, *of Illinois.*

EDWARD A. MOSELEY, *Secretary.*



At a General Session of the INTERSTATE COMMERCE  
COMMISSION, held at its office in Washington, D. C.,  
on the 1st day of June, 1908.

*Present:*

MARTIN A. KNAPP,	} Commissioners.
JUDSON C. CLEMENTS,	
CHARLES A. PROUTY,	
FRANCIS M. COCKRELL,	
FRANKLIN K. LANE,	
EDGAR E. CLARK,	
JAMES S. HARLAN,	

The subject of a Uniform System of Accounts to be prescribed for and kept by carriers being under consideration, the following order was entered:

*It is ordered,* That the Supplement to the Classification of Operating Expenses, Third Revised Issue, and the text pertaining thereto, prepared under the direction of this Commission by Henry C. Adams, in charge of Statistics and Accounts, and embodied in printed form to be hereafter known as Supplement to the Third Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Division of Statistics and Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

*It is further ordered,* That the said Supplement to the Third Revised Issue be, and is hereby, prescribed for the





## INTRODUCTORY LETTER.

ADDED TO THE THIRD ISSUE OF THE CLASSIFICATION  
OF OPERATING EXPENSES AND ACCOUNTS,  
Washington, June 15, 1908.

TO CARROLL C. CONVERSE.

The first revised issue of the Classification of Operating Expenses took effect on July 1, 1894, and the second revised issue became effective on July 1, 1904. The Classification now in force dates from July 1, 1907.

It is found advisable to make a few changes in this Classification to become effective on July 1, 1908, and it is the purpose of this Supplement to the Third Revised Issue to indicate such changes. They are not of sufficient importance to warrant the publication of a fourth revised issue at this time. In this Supplement will be found, under the title of each primary account in the prescribed Classification of Operating Expenses, a statement, first, of the changes made in the text descriptive of the several accounts, and second, reference to the cases published in Accounting Bulletin No. 1, which furnish an explanation of some of the amendments to the original text herewith promulgated. It thus appears that this Supplement will serve as an index in the cases bearing upon the interpretation of the several primary accounts, as well as authority for modifications in the text of such accounts.

The following are the important changes in the Classification:

(a) The three accounts "Work Equipment—Repairs," "Work Equipment—Renewals," and "Work Equipment—Depreciation," which in the Third Revised Issue, are included as primary accounts under the general account "Maintenance of Way and Structures," are transferred to the general account "Maintenance of Equipment."

(b) The two accounts "Equipment Borrowed—Dr." and "Equipment Loaned—Cr.," being primary accounts under the general account "Maintenance of Equipment," are eliminated. This eliminates, also, the Clearing Account—Hire of Equipment. The elimination of these accounts means that the separation of the per diem for interchanged cars, and of the rental charge for hire of equipment, between operating expenses and income account will no longer be required, the entire amounts of payments and receipts for equipment interchanged or otherwise acquired or let out for use being carried directly to the Income Account.

(c) The insurance accounts formerly appearing as primary accounts under the general accounts now appear as a consolidated account under "General Expenses."

(d) The account "Stock Yards and Grain Elevators" under "Transportation Expenses" has been eliminated, as the expense which might be classified under that head is covered by the Transportation Expense accounts "Station Employees" and "Station Supplies and Expenses."

(e) A note has been added to the accounts applying to the operation of electric divisions stating that carriers who wish to subdivide those accounts should use appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railroads, which becomes effective on October 1, 1908. The accounts in the Steam Road classification and the corresponding accounts in the Electric Road classification are as follows:

## STEAM

5. Other Truck Material.

6. Roadway and Track.

## ELECTRIC

4. Rail Fastenings and Joints.

5. Special Work.

8. Roadway and Track Labor.

9. Fixing.

## STEAM.

## ELECTRIC.

- |                                     |   |
|-------------------------------------|---|
|                                     | 10. Miscellaneous—Roadway and Track Expense.                |
|                                     | 11. Cleaning and Sanding Track.                             |
| 9. Bridges, Trestles, and Culverts. | 11. Elevated Structures and Foundation.                     |
|                                     | 12. Bridges, Trestles, and Culverts.                        |
| 12. Electric Power Transmission.    | 20. Poles and Fixture.                                      |
|                                     | 21. Underground Conductors.                                 |
|                                     | 22. Transmission System.                                    |
|                                     | 23. Distribution System.                                    |
|                                     | 24. Miscellaneous—Electric Line Expense.                    |
| 13. Power Plant Equipment.          | 30. Power Plant Equipment.                                  |
|                                     | 31. Substation Equipment.                                   |
| 14. Motormen.                       | 40. Power Plant Conductors, Motormen, and Trainmen.         |
| 15. Road Trainmen.                  | 41. Freight and Express Conductors, Motormen, and Trainmen. |
| 16. Operating Power Plant.          | 42. Power Plant Employees.                                  |
|                                     | 43. Substation Employees.                                   |
|                                     | 44. Fuel for Power.   |
|                                     | 45. Water for Power.  |
|                                     | 46. Lubricant for Power.                                    |
|                                     | 47. Miscellaneous—Power Plant Supplies and Expenses.        |
|                                     | 48. Substation Supplies and Expenses.                       |

Correspondence with this office during the past year has indicated a desire, on the part of a large number of carriers doing a relatively small business, for a condensed Classification of Operating Expenses. A condensed

Classification has accordingly been provided under the title "Third Revised Issue, Condensed," containing forty-four accounts. Inasmuch, however, as this Classification is designed for switching and terminal roads, as well as for small commercial roads not forming parts of large operating systems, and inasmuch as, further, many of these roads will have no use for the joint-facilities accounts, the actual number of primary accounts which this class of roads will be obliged to keep will, in many cases, not exceed twenty-five or thirty.

HENRY C. ADAMS,

*In charge of Statistics and Accounts*

## SUPPLEMENT TO THE INTRODUCTORY LETTER.

Amend the Introductory Letter to the Classification of Operating Expenses for Steam Roads, Third Revised Issue, by striking out all from and including the heading "Per Diem and Mileage Payments Between Carriers," on page 12, down to and including the word "carrier," in the eleventh line on page 16.

Hereafter such payments will be handled through the Income Account.

For interpretation of the text relative to Depreciation and Replacement accounts, pages 10-12 of this introductory letter, see Cases 33, 36, 40, 48, 49, 106, 107, 108, 109, 112, 147, 167, 168, 169, 170, 171, 172, 174, 175, 176, Accounting Bulletin No. 1.

*Index to Cases in Accounting Bulletin No. 1 not referable to specific accounts in this classification.*

GENERAL. Cases 1, 2, 3, 4, 5, 6, 9, 33, 69, 71, 72, 106, 111, 112, 114, 115, 153, 154, 155, 157, 158, 162, 173, 188, 189, 190, 191, 192, 211, 224, 235, 246, 248, 257, 262, and 298.

OUTSIDE OPERATIONS. Cases 1, 24, 25, 27, 55, 136, 137, 138, 142, 143, 182, 199, and 200.

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## PRIMARY ACCOUNTS.

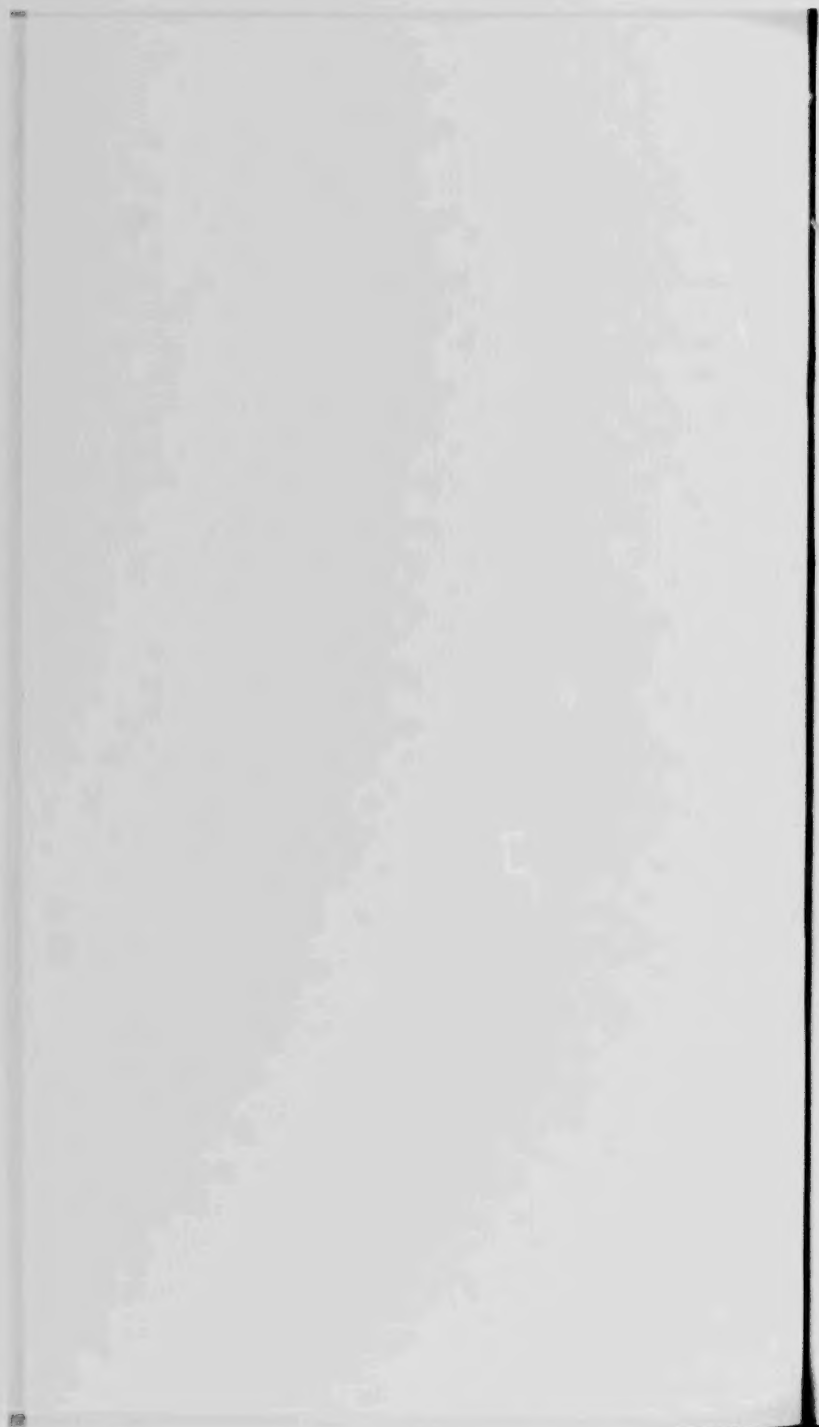
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## SUPPLEMENT TO THE TEXT OF CLASSIFICATION OF OPERATING EXPENSES FOR STEAM ROADS.

### I. MAINTENANCE OF WAY AND STRUCTURES.

#### 1. SUPERINTENDENCE.

PAY OF OFFICERS.—Add: "Pay of fire chiefs."

OFFICE AND OTHER EXPENSES.—Add: "Subscriptions to newspapers and periodicals."

(For interpretation of this account see Cases 37, 246, and 262, Accounting Bulletin No. 1.)

#### 2. BALLAST.

After the second line on page 23, as part of paragraph lettered (a), add:

"Also amounts paid for the right to enter upon and remove ballast from lands not owned by the carrier."

After the lettered paragraphs on page 23 add a new paragraph:

"(c) Cost of installing and operating interlocking and other signal apparatus at gravel pits."

(For interpretation of this account see Cases 39, 40, 106, 114, 158, 163, and 297, Accounting Bulletin No. 1.)

#### 3. TIES.

First line of text, after the word "inspection" in parentheses, add: "And freight charges, if any."

(For interpretation of this account see Cases 32, 40, 106, 157, 158, and 162, Accounting Bulletin No. 1.)

#### 4. RAILS.

First line of text, after the word "inspection" in parentheses, add: "And freight charges, if any."

(For interpretation of this account see Cases 32, 40, 106, 157, 158, and 162, Accounting Bulletin No. 1.)

#### 5. OTHER TRACK MATERIAL.

Eliminate from the list of articles chargeable to this account, third column, second item, the words

and keys.



In the first line of text, after the word "Cost," insert: "(including inspection and freight charges, if any)."

Add to the list of articles on page 25:

End clips.  
Shims.  
Track insulators.

Add:

NOTE A. This account may include each month a proportion of the total amount authorized or approximated for renewals during the fiscal year regardless of the month in which the actual renewal is made.

NOTE B. When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Cases 40, 106, 157, 158, and 299, Accounting Bulletin No. 1.)

#### 6. ROADWAY AND TRACK.

General Cleaning. Add: "Cleaning car-cleaning yards."

Train Service. Add: "Cost of oil for lubricating work trains."

Add:

NOTE. When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Cases 6, 38, 41, 157, 158, and 215, Accounting Bulletin No. 1.)

#### 7. REMOVAL OF SNOW, SAND, AND ICE.

Add: "Cost of oil for lubricating work trains."

#### 8. TUNNELS.

No change.

(For interpretation of this account see Cases 40 and 106, Accounting Bulletin No. 1.)

#### 9. BRIDGES, TRETTLES, AND CULVERTS.

Add to last paragraph: "Cost of oil for lubricating work trains."

NOTE C. Add, after the word "account:"

Insurance recovered for total destruction of bridges, trestles, and culverts should be credited to an appropriate suspense account, which account should be charged with the cost of replacement. If the cost of replacement is in excess of the amount of insurance recovered, the excess should be charged to this account.



**Add**

NOTE D.—When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Cases 30, 31, 32, 38, 40, 106, 146, 148, and 162, Accounting Bulletin No. 1.)

**10. OVER AND UNDER GRADE CROSSINGS**

No change

**11. GRADE CROSSINGS, FENCES, CATTLE GUARDS, AND SIGNS**

No change

**12. SNOW AND SAND FENCES AND SNOWSHEDS**

No change

**13. SIGNALS AND INTERLOCKING PLANTS**

OTHER EXPENSES—Add: "Bonding rails."

(For interpretation of this account see Cases 39 and 42, Accounting Bulletin No. 1.)

**14. TELEGRAPH AND TELEPHONE LINES**

Add: "Cost of oil for lubricating work trains."

Add:

NOTE E.—This account may include each month a proportion of the total amount authorized or approximated for renewals during the fiscal year, regardless of the month in which the actual renewal is made.

**15. ELECTRIC POWER TRANSMISSION**

Add:

NOTE.—When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

**16. BUILDINGS, FIXTURES, AND GROUNDS**

REPAIRS.—Add: "Payments to municipalities and others for fire protection."

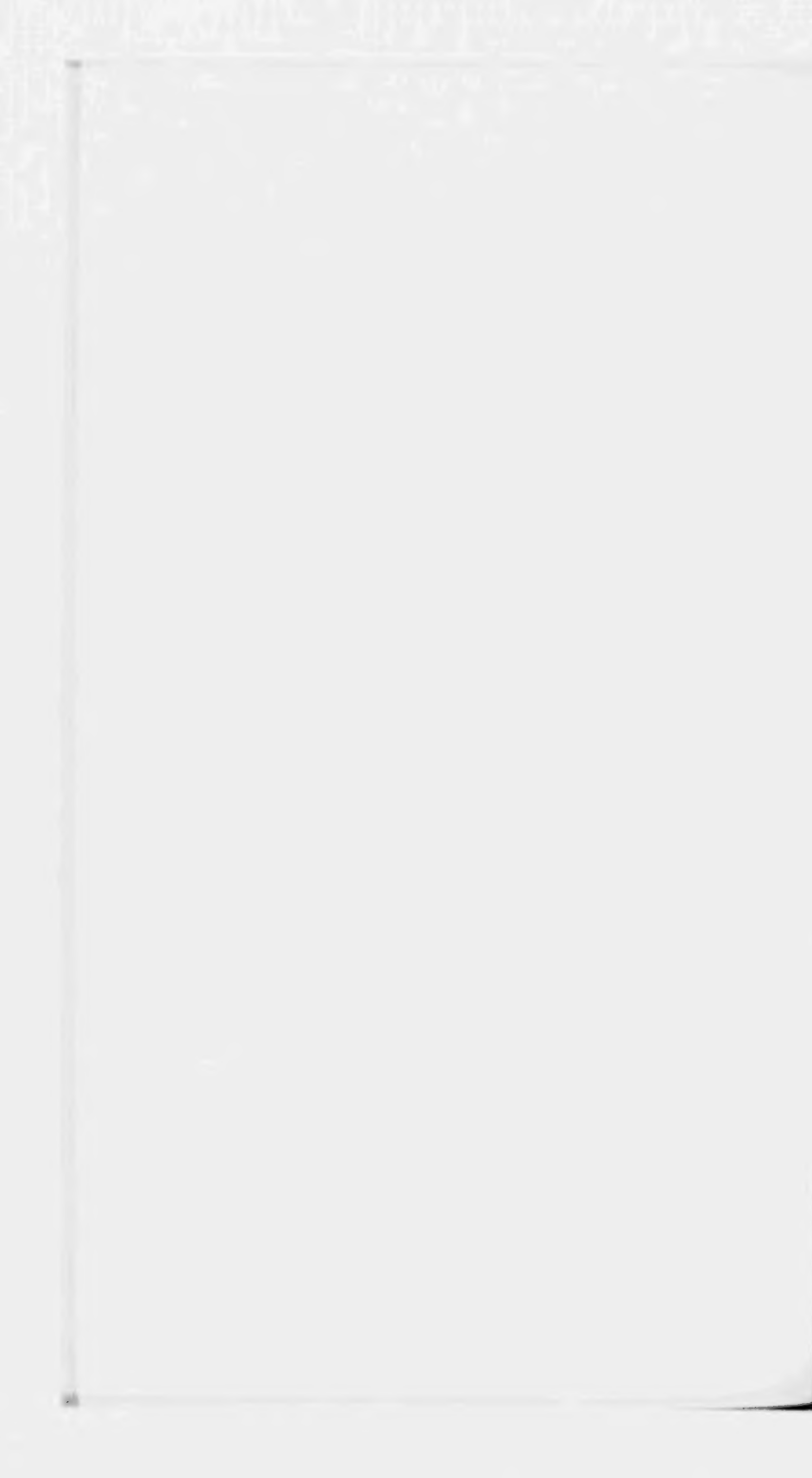
Add to the list:

Platforms—shop and yard.

Rest houses.

Scale houses.

OTHER EXPENSES.—Add, after the word "salvage" in the first line of this subaccount, the words "and labor expended."





**Gross Sales.** Add: "Cost of oil for lubricating work trains."

**NOTE B.** Add, after the word "account":

"Insurance recovered for total destruction of buildings and fixtures should be credited to an appropriate suspense account, which account should be charged with the cost of replacement. If the cost of replacement is in excess of the amount of insurance recovered, the excess should be charged to this account."

(For interpretation of this account see Cases 30, 31, 32, 40, 44, 106, 162, 178, and 306, Accounting Bulletin No. 1.)

# 17. DOCKS AND WHARVES.

In the third line of text, after the words "transfer bridges," insert: "and machinery used in connection therewith."

Add to last paragraph: "Cost of oil for lubricating work trains."

**NOTE A.** Page 3, amend to read: "Cost of maintenance of tracks, buildings, and machinery on docks, wharves, and other structures enumerated in this account shall be charged to other appropriate accounts herein provided except machinery used in connection with ferry slips and transfer bridges."

# 18. ROADWAY TOOLS AND SUPPLIES.

Add:

Switch keys

(For interpretation of this account see Cases 246, 262, and 299, Accounting Bulletin No. 1.)

## WORK EQUIPMENT—REPAIRS.

## WORK EQUIPMENT—RENEWALS.

## WORK EQUIPMENT—DEPRECIATION.

These primary accounts are transferred to the general account "Maintenance of Equipment," where they appear as primary accounts Nos. 43, 44, and 45.

# 19. INJURIES TO PERSONS.

Add: "Pay and expenses of employees and others while attending coroners' inquests or engaged as witnesses in lawsuits in connection with personal injury cases."

**NOTE A.** Eliminate the words "witness fees and other expenses" and substitute in place thereof the words "expenses, not otherwise provided for."

(For interpretation of this account see Cases 4, 34, 155, 164, 165, 304, and 310, Accounting Bulletin No. 1.)



## 20. STATIONERY AND PRINTING.

No change.

(For interpretation of this account see Cases 154 and 155, Accounting Bulletin No. 4.)

## INSURANCE.

This account is eliminated; cost of all insurance to be charged to primary account No. 140, "Insurance," under general account "General Expenses."

## 21. OTHER EXPENSES.

No change.

## 22. MAINTAINING JOINT TRACKS, YARDS, AND OTHER FACILITIES—DR.

No change.

(For interpretation of this account see Cases 46, 117, 159, 161, 258, 268, and 295, Accounting Bulletin No. 4.)

## 23. MAINTAINING JOINT TRACKS, YARDS, AND OTHER FACILITIES—CR.

No change.

(For interpretation of this account see Cases 46, 159, 161, 258, 268, and 295, Accounting Bulletin No. 4.)

## II. MAINTENANCE OF EQUIPMENT.

## 24. SUPERINTENDENCE.

Office and Other Expenses. Add: "Subscriptions to newspapers and periodicals."

(For interpretation of this account see Cases 248 and 264, Accounting Bulletin No. 4.)

## 25. STEAM LOCOMOTIVES—REPAIRS.

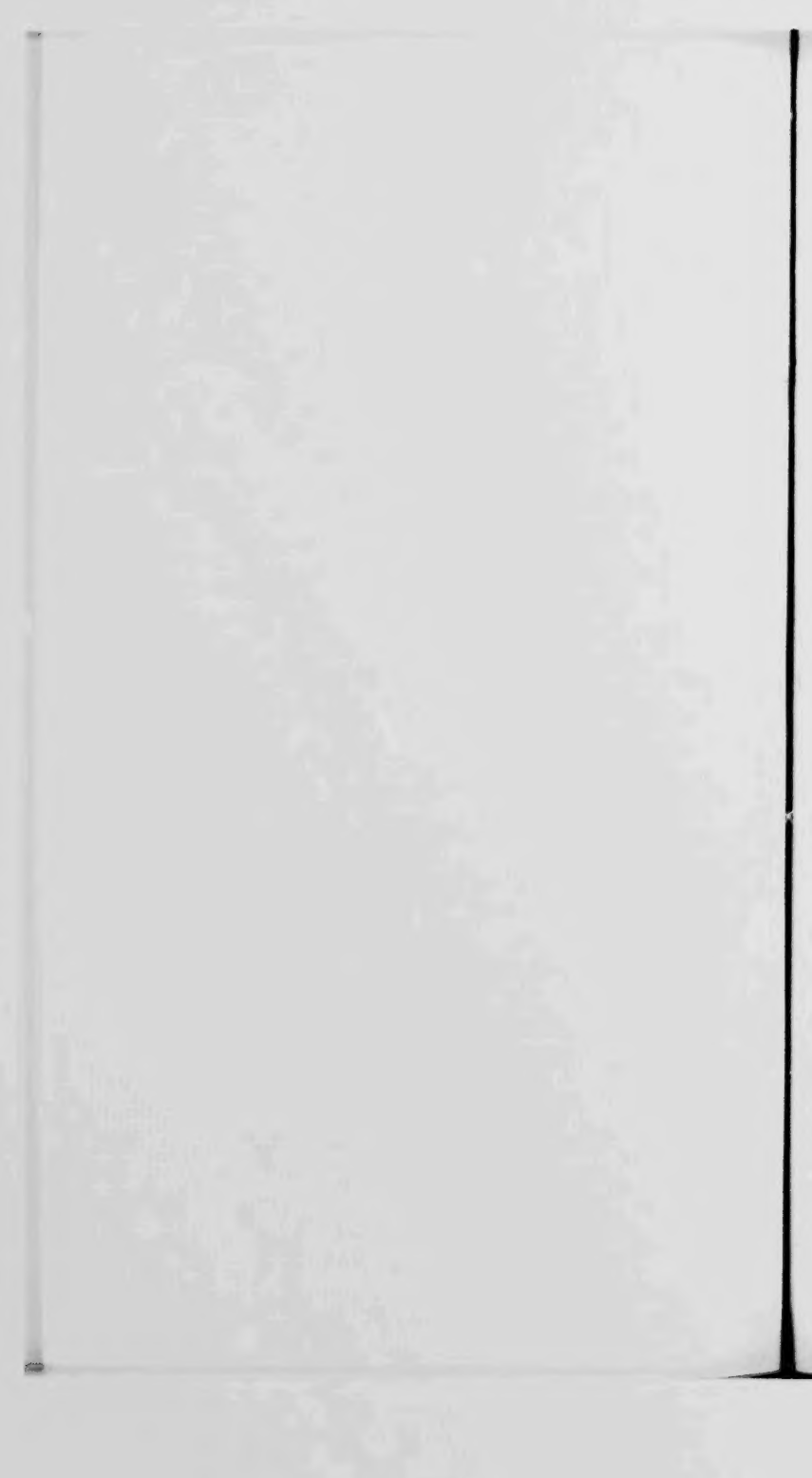
Add: "Cost of repairs to the locomotive feature of motor cars (other than electric) engaged in revenue service."

Add: "Metallic packing."

(For interpretation of this account see Cases 53, 54, 73, 256, and 264, Accounting Bulletin No. 4.)

## 26. STEAM LOCOMOTIVES—RENEWALS.

No change.



## STEAM LOCOMOTIVES—DEPRECIATION

It was the text of this account to read:

This account includes a monthly charge representing depreciation on steam locomotives. This monthly charge should be computed at a certain rate per cent on the original cost estimate of each locomotive, minus value of any other property and material furnished as charges. In the first month, this account should also list in the column for depreciation the value of property furnished, which will be the same as a locomotive. In future months, it will show when the steam is received, the amount paid for it, the cost of less than a new locomotive, and when it is sold, the amount received for it. It will also show the original cost of the locomotive, less the amount of depreciation, and the amount of the monthly charge for depreciation. It will also show the amount of the monthly charge for depreciation, less the amount of the monthly charge for depreciation, and the amount of the monthly charge for depreciation, less the amount of the monthly charge for depreciation.

Example:—Suppose a locomotive is purchased for \$10,000, and the monthly depreciation is \$100. The account should be as follows:—

Example:—Suppose a locomotive is purchased for \$10,000, and the monthly depreciation is \$100. The account should be as follows:—

Example:—Suppose a locomotive is purchased for \$10,000, and the monthly depreciation is \$100. The account should be as follows:—

## 28. ELECTRIC LOCOMOTIVES—REPAIRS

No charge.

For depreciation on this account see Case 29b Accounting for Depreciation.

## 29. ELECTRIC LOCOMOTIVES—RENEWALS

No charge.

## 30. ELECTRIC LOCOMOTIVES—DEPRECIATION

It was the text of this account to read:

This account includes a monthly charge representing depreciation on electric locomotives. This monthly charge should be computed at a certain rate per cent on the original cost esti-



nated, if not known, record value, or purchase price of such electric locomotives. Charges should be made to this account during the life of the electric locomotives, except in cases of electric locomotives which attain to greater than a normal life. In such case, charges should cease when the difference between the original cost, record value, or purchase price and the estimated scrap value shall have been charged to this account. In case of electric locomotives prematurely retired, charges to this account should cease with the charges for the month in which such retirement occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.

NOTE A.—When electric locomotives are prematurely retired, the value destroyed, not previously taken up through charges to this account, should be charged to the account for the month in which retired, to Account No. 29, "Electric Locomotives—Renewals," as provided in the text hereof.

NOTE B.—The sum of the monthly charges to this account should equal the value lost through depreciation in respect to a particular electric locomotive, and, together with the charge to "Electric Locomotives—Renewals," and value of salvage or amount received from sale, should provide a reserve for replacement of the electric locomotive when retired.

### 31. PASSENGER-TRAIN CARS—REPAIRS.

Add: "Cost of repairs to the car feature of motor cars engaged in passenger service."

NOTE A.—Eliminate from the list:

Buffet,	Dining,	Parlor baggage,
Cafe,	Carboy,	Tourist.

Eliminate the seventh line of text on page 46 and substitute in place thereof: "The cost of general or shop repairs of;" so that it will read:

The cost of general or shop repairs of cars, the operations of which are treated as "Outside Operations," should not be charged to this account.

(For interpretation of this account see Cases 55, 73, 138, and 264, Accounting Bulletin No. 1.)

### 32. PASSENGER-TRAIN CARS—RENEWALS.

No change.

(For interpretation of this account see Case 55, Accounting Bulletin No. 1.)





## 33. PASSENGER-TRAIN CARS—DEPRECIATION.

Revise the text of this account to read:

This account includes a monthly charge representing depreciation on passenger-train cars. This monthly charge should be computed at a certain rate per cent on the original cost (estimated if not known), record value, or purchase price of such passenger-train cars. Charges should be made to this account during the life of the passenger-train cars, except in cases of passenger-train cars which attain to greater than a normal life; in such a case charges should cease when the difference between the original cost, record value, or purchase price and the estimated scrap value shall have been charged to this account. In case of passenger-train cars prematurely retired charges to this account should cease with the charges for the month in which such retirement occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.

NOTE A.—When a passenger-train car is prematurely retired, the value (if known), or, not previously determined, through charges to this account, should be charged in the account for the month in which retired. In Account No. 34, Freight-Train Cars, Renewals, as provided in the text therein.

NOTE B.—The sum of the monthly charges to this account should equal the value lost through depreciation on cost of the particular passenger-train car, and cost of such depreciation should be charged to Freight-Train Cars, Renewals, and cost of such depreciation incurred from cars should properly be reflected to the passenger-train car when retired.

For interpretation of this account see Case 55, Accounting Bulletin No. 1.

## 34. FREIGHT-TRAIN CARS—REPAIRS.

NOTE A.—Add to debit of beginning of first column of Bulletin, when in commercial service.

For interpretation of this account see Cases 47, 56, 245, and 264, Accounting Bulletin No. 1.

## 35. FREIGHT-TRAIN CARS—RENEWALS.

No change.

## 36. FREIGHT-TRAIN CARS—DEPRECIATION.

Revise the text of this account to read:

This account includes a monthly charge representing depreciation on freight-train cars. This monthly charge should be computed at a certain rate per cent on the original cost (estimated if not known), record value, or purchase price of such freight-train cars. Charges should be made to this account during the life of the freight-train cars, except in cases of freight-train



cars which attain to greater than a normal life, in such a case charges should cease when the difference between the original cost, record value, or purchase price and the estimated scrap value shall have been charged to this account. In case of freight-train cars prematurely retired charges to this account should cease with the charges for the month in which such retirement occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.

NOTE A. When freight-train cars are prematurely retired, the value (less salvage) not previously taken up through charges to this account should be charged, in the accounts for the months in which retired, to Account No. 35, "Freight-train Cars—Renewals," as provided in the text hereof.

NOTE B. The sum of the monthly charges to this account should equal the value lost through depreciation in respect to a particular freight-train car, and together with the charge to "Freight-train Cars—Renewals," and value of salvage or amount received from sale, should provide a reserve for replacement of the freight-train car when retired.

### 37. ELECTRIC EQUIPMENT OF CARS—REPAIRS

Add:

NOTE B. When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Case 57, Accounting Bulletin No. 1.)

### 38. ELECTRIC EQUIPMENT OF CARS—RENEWALS.

Add:

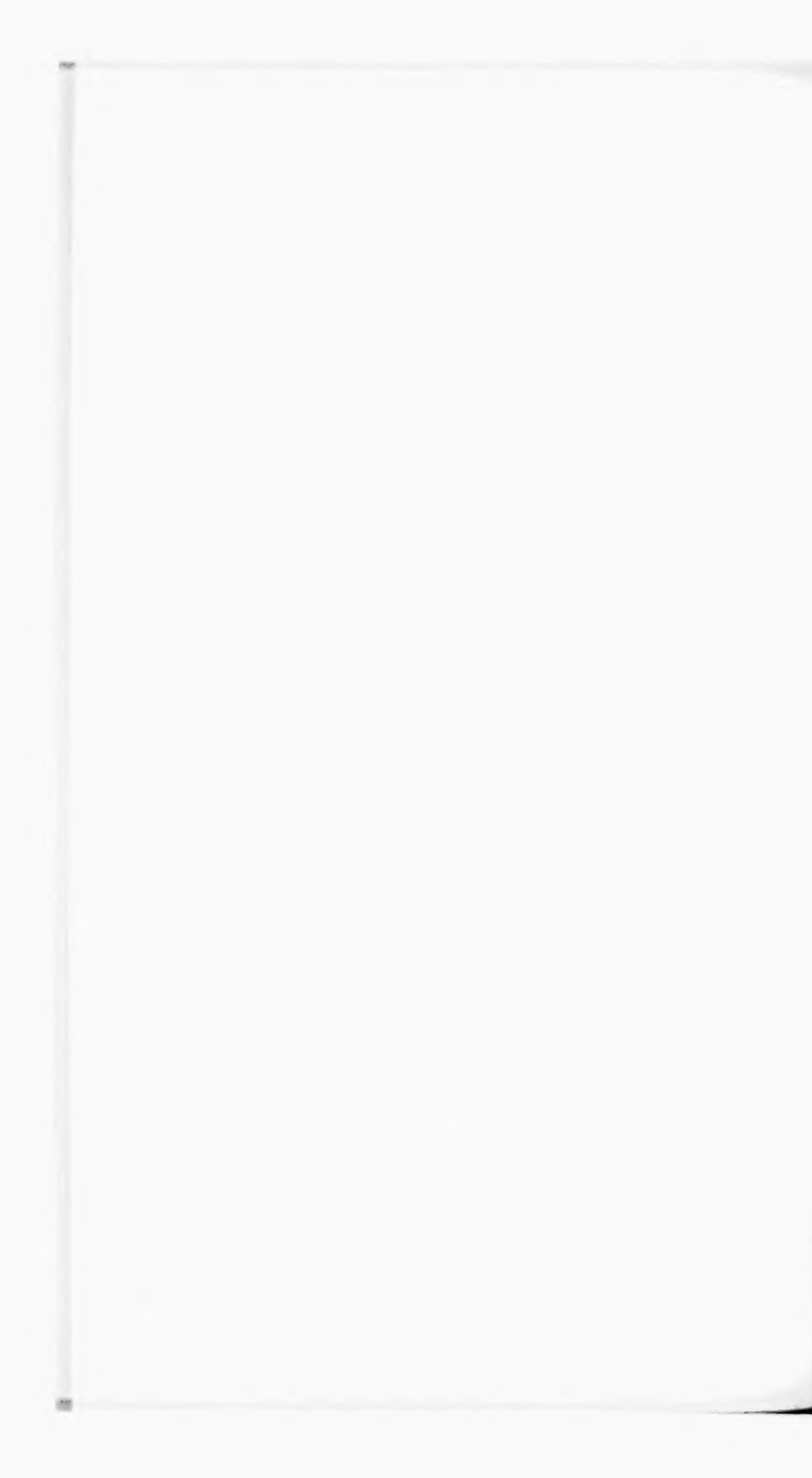
NOTE C. When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Case 57, Accounting Bulletin No. 1.)

### 39. ELECTRIC EQUIPMENT OF CARS—DEPRECIATION.

Revise the text of this account to read:

This account includes a monthly charge representing depreciation on electric equipment of cars. This monthly charge should be computed at a certain rate per cent on the original cost (estimated if not known), record value, or purchase price of such electric equipment of cars. Charges should be made to this account during the life of the electric equipment of cars, except in cases of electric equipment of cars which attains to greater than a normal life; in such a case charges should cease when the difference between the original cost, record value, or purchase



price and the estimated scrap value shall have been charged to this account. In case of electric equipment of cars prematurely retired charges to this account should cease with the charges for the month in which such retirement occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.

NOTE A. When electric equipment of cars is prematurely retired, the value (less salvage) not previously taken up through charges to this account should be charged, in the account for the month in which retired, to Account No. 38, "Electric Equipment of Cars—Removal," as provided in the text thereto.

NOTE B. The sum of the monthly charges to this account should equal the value lost through depreciation in respect to a particular electric equipment of cars, and together with the charges to "Electric Equipment of Cars—Renewals" and "Electric Equipment of Cars—Replacement" should provide a reserve for replacement of the electric equipment of cars when retired.

For interpretation of this account see Case 37, Accounting Bulletin No. 14.

#### 10. FLOATING EQUIPMENT—REPAIRS

No change

#### 11. FLOATING EQUIPMENT—RENEWALS

No change

#### 12. FLOATING EQUIPMENT—DEPRECIATION

Revise the text of this account to read:

This account includes a monthly charge representing depreciation on floating equipment. This monthly charge should be computed at a certain rate per cent on the original cost, estimated (if not known) record value, or purchase price of such floating equipment. Charges should be made to this account during the life of the floating equipment, except in case of floating equipment which attains to greater than a normal life in which case charges should cease when the difference between the original cost, record value, or purchase price and the estimated scrap value shall have been charged to this account. In case of floating equipment prematurely retired charges to this account should cease with the charges for the month in which such retirement occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.



Note A. When floating equipment is prematurely retired, the value less salvage, not previously taken up through charges to this account, should be charged in the account for the month in which retired. To Account No. 44, "Floating Equipment—Renewals," as provided in the text thereon.

Note B. The sum of the monthly charges to this account should equal the value less through depreciation in respect to particular floating equipment, and together with the charges to "Floating Equipment—Renewals" and value of salvage or amount received from sale, should provide a reserve for replacement of the floating equipment when retired.

### 43. WORK EQUIPMENT—REPAIRS.

(For text of this account see pages 36, 37, and 38, Classification of Operating Expenses, Third Revised Issue.)

Eliminate clause on pages 36-37, "also cost of repairing commercial cars and locomotives when assigned to and in maintenance of way service," and amend the succeeding clause to read: "charges made in commercial cars to fit them for work service," etc.

(For interpretation of this account see Cases 47, 235, and 264, Accounting Bulletin No. 1.)

### 44. WORK EQUIPMENT—RENEWALS.

No change.

(For text of this account see page 38, Classification of Operating Expenses, Third Revised Issue.)

### 45. WORK EQUIPMENT—DEPRECIATION.

(For text of this account see page 38, Classification of Operating Expenses, Third Revised Issue.)

Revise the text of this account to read:

This account includes a monthly charge representing depreciation on work equipment. This monthly charge should be computed at a certain rate per cent on the original cost, estimated if not known, record value, or purchase price of such work equipment. Charges should be made to this account during the life of the work equipment, except in cases of work equipment which attains to greater than a normal life, in such a case charges should cease when the difference between the original cost, record value, or purchase price and the estimated scrap value shall have been charged to this account. In case of work equipment prematurely retired charges to this account should cease with the charges for the month in which such retirement





occurs. The sum of the monthly charges during any fiscal year should equal the estimated depreciation during that year.

NOTE A.—When work equipment is purchased by the railway and the salvage not previously taken up through credits in the account should be charged, in the accounts for the month in which received, to Account No. 14, "Work Equipment—Renewal," as purchases in respect thereof.

NOTE B.—The sum of the monthly charges to "Salvage" should equal the value lost through depreciation in respect to the particular work equipment, and together with the charge to "Work Equipment—Renewal" and value of salvage or amount received therefor, should provide a reserve for replacement of the work equipment when required.

#### 46. SHOP MACHINERY AND TOOLS.

REPAIRS.—Add: "Cost of repairing electric power plants (and parts thereof) employed exclusively in connection with the operation of machinery in shops."

In the third line of this paragraph, after the word "foundries," add: "and in shops of the bridges and buildings department."

RENEWALS.—Add: "Cost of renewing electric power plants (and parts thereof) employed exclusively in connection with the operation of machinery in shops."

In the third line of this paragraph, after the word "foundries," add: "and in shops of the bridges and buildings department."

Add:

NOTE.—When carriers operating electric divisions or use the subway in this account, appropriate accounts, as prescribed in the classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Cases 58, 478, and 514, Accounting Bulletin No. 1.)

#### 47. POWER PLANT EQUIPMENT.

Add:

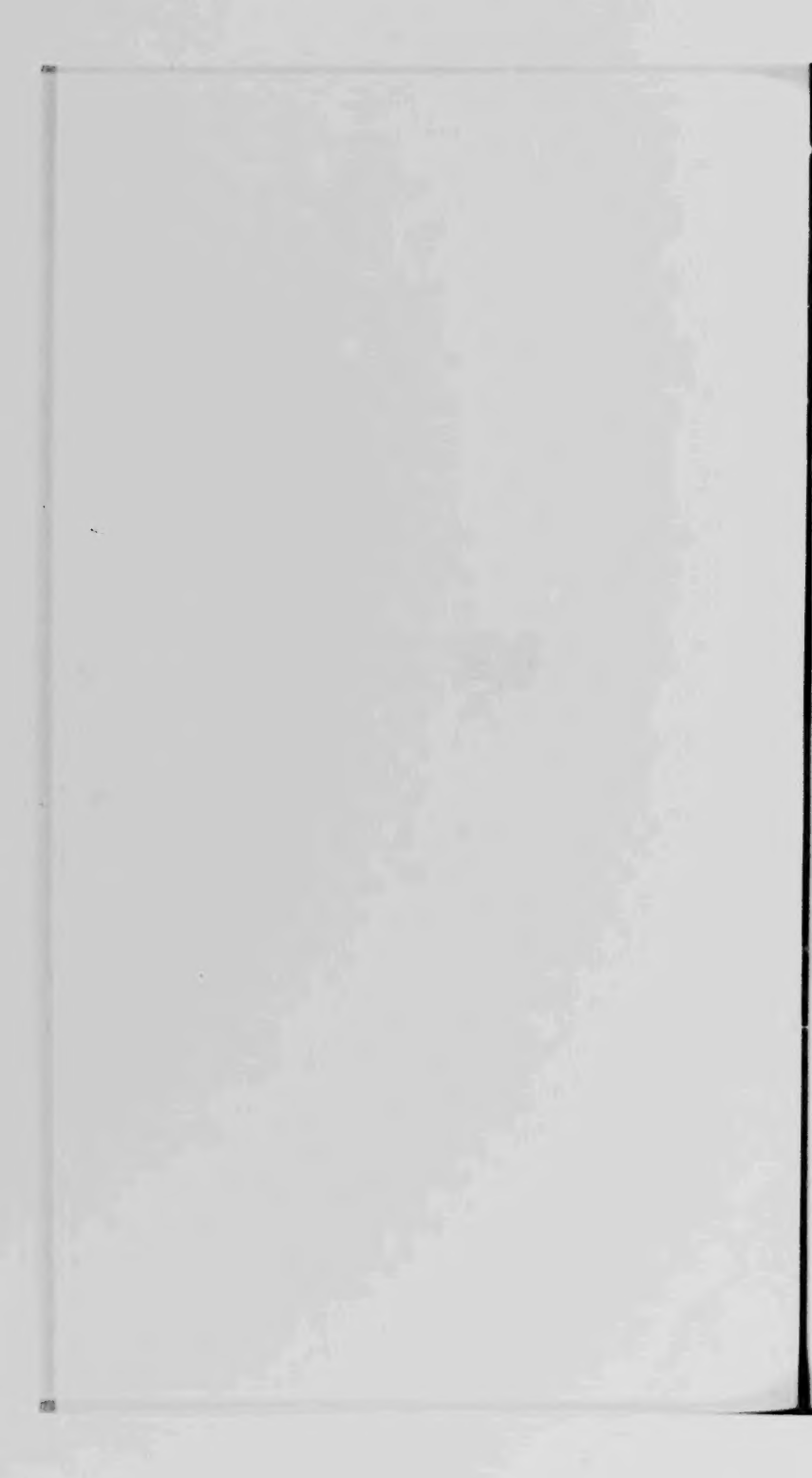
NOTE.—This account includes only the cost of repairing and renewing equipment of plants used for furnishing power for the propulsion of electric locomotives, cars, or trams.

(For interpretation of this account see Cases 58, 59, and 478, Accounting Bulletin No. 1.)

#### 48. INJURIES TO PERSONS.

Add: "Pay and expenses of employees and others while attending coroner's inquests or engaged as witnesses in lawsuits in connection with personal injury cases."

NOTE A.—Eliminate the words "witness fees and other expenses" and substitute in place thereof the words "expenses not otherwise provided for."



(For interpretation of this account, see Cases 34, 155, and 310, Accounting Bulletin No. 1.)

#### 49. STATIONERY AND PRINTING.

No change.

(For interpretation of this account, see Cases 154 and 155, Accounting Bulletin No. 1.)

#### INSURANCE.

This account is eliminated, cost of all insurance to be charged to primary account No. 110, "Insurance," under general account "General Expenses."

#### 50. OTHER EXPENSES.

No change.

#### CLEARING ACCOUNT "SHOP EXPENSES" (Page 55).

Add a new paragraph:

POWER.—Cost of fuel, including freight charges and handling, used in operating steam and electric power plants at shops and other places at which mechanical work is done; oil, grease, waste, and other material used in the operation of such power plants; pay of stationary engineers, firemen, electricians, coal handlers, and other employees; carbon brushes, fuses, lamps, picks, pickers, scuttles, shovels, and other small tools and supplies; cost of water and power purchased.

(For interpretation of this account see Cases 59, 60, 173, 177, 179, 180, 183, and 248 and 257, Accounting Bulletin No. 1.)

#### CLEARING ACCOUNT "STORE EXPENSES" (Page 58)

No change.

(For interpretation of this account see Cases 9, 61, 153, 155, 181, 184, 185, 246, and 262 Accounting Bulletin No. 1.)

#### ADDITIONAL CLEARING ACCOUNTS AUTHORIZED:

For "Studies" by the Engineering Department. See Case 7.

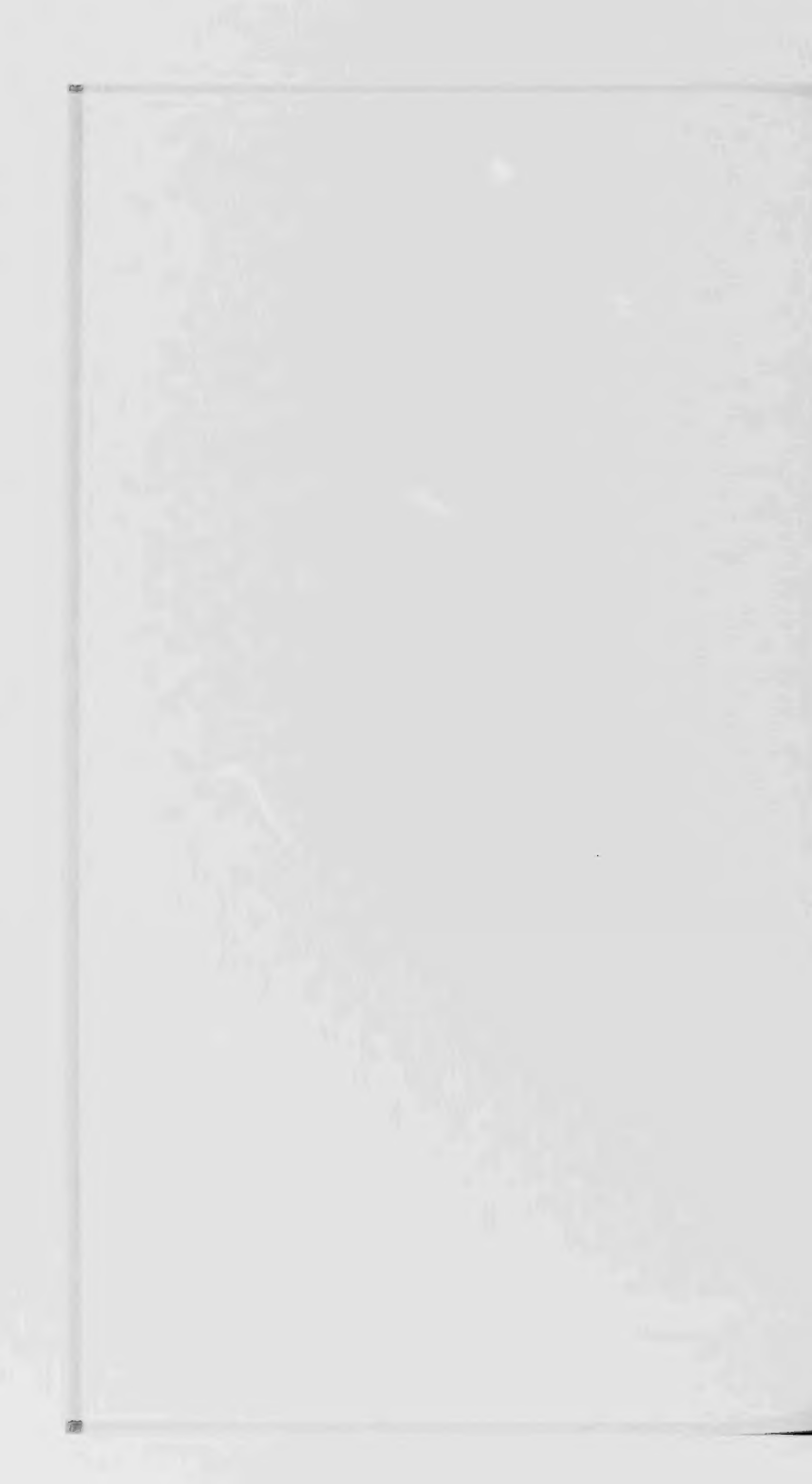
For Stationer's expenses. See Case 154.

For Power Plant expenses. See Cases 178 and 180.

#### 51. MAINTAINING JOINT EQUIPMENT AT TERMINALS—DR.

No change.

(For interpretation of this account see Case 46, Accounting Bulletin No. 1.)



## EQUIPMENT BORROWED—DR.

This account is eliminated.

## 52. MAINTAINING JOINT EQUIPMENT AT TERMINALS—CR.

No change.

(For interpretation of this account see Case 46, Accounting Bulletin No. 1.)

## EQUIPMENT LOANED—CR.

This account is eliminated.

## III. TRAFFIC EXPENSES.

## 53. SUPERINTENDENCE.

OFFICE AND OTHER EXPENSES.—Add: "Subscriptions to newspapers."

## 54. OUTSIDE AGENCIES.

No change.

## 55. ADVERTISING.

No change.

## 56. TRAFFIC ASSOCIATIONS.

No change.

(For interpretation of this account see Case 271, Accounting Bulletin No. 1.)

## 57. FAST FREIGHT LINES.

No change.

## 58. INDUSTRIAL AND IMMIGRATION BUREAUS.

No change.

(For interpretation of this account see Case 244, Accounting Bulletin No. 1.)

## 59. STATIONERY AND PRINTING.

No change.

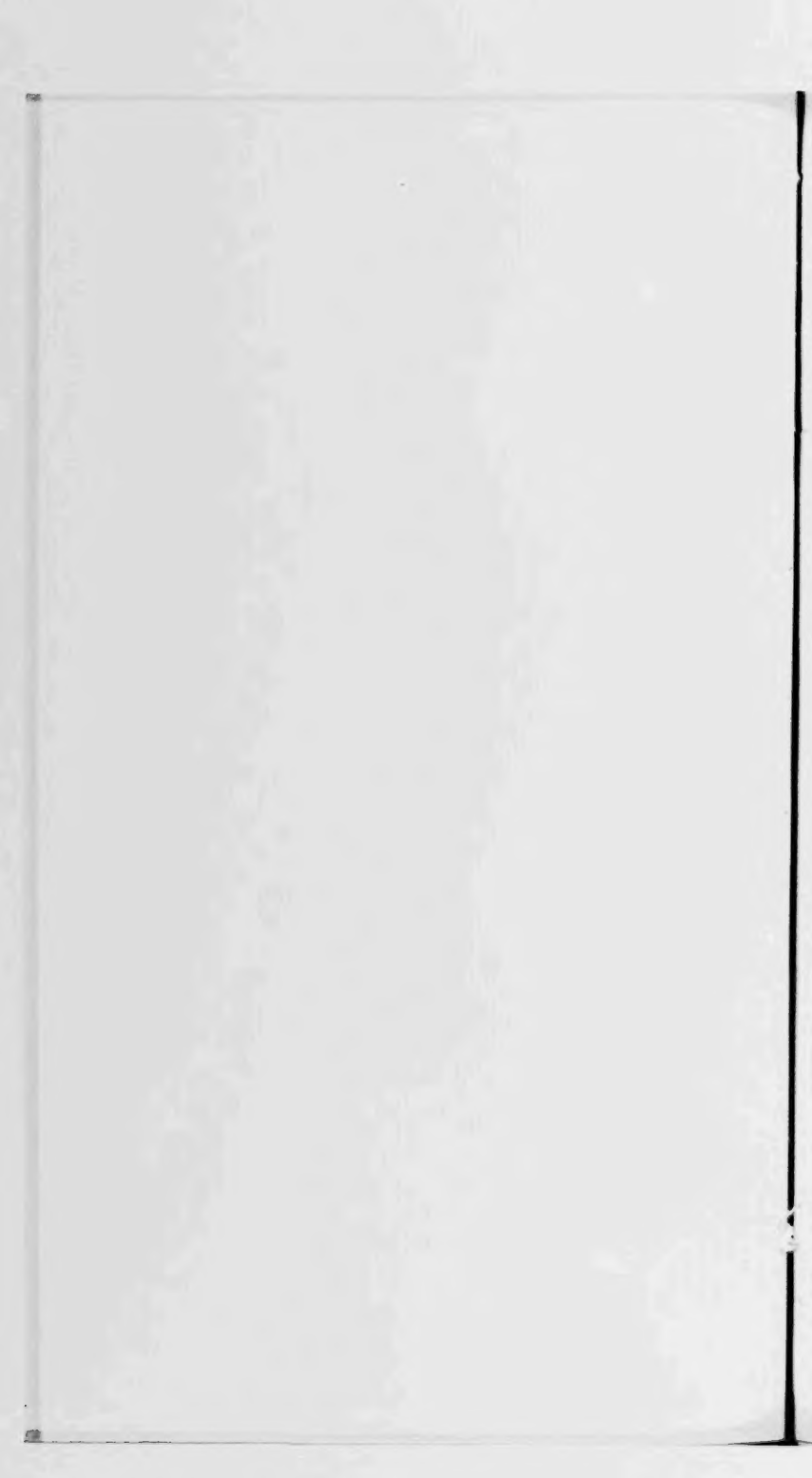
(For interpretation of this account see Cases 154, 155, and 244, Accounting Bulletin No. 1.)

## INSURANCE.

This account is eliminated, cost of all insurance to be charged to primary account No. 110, "Insurance," under general account, "General Expenses."

## 60. OTHER EXPENSES.

No change.



## IV. TRANSPORTATION EXPENSES.

## 61. SUPERINTENDENCE.

PAY OF OFFICERS.—Add: "Chief special agents."

OFFICE AND OTHER EXPENSES.—Add: "Subscriptions to newspapers."

(For interpretation of this account see Cases 62, 246, 254, and 262, Accounting Bulletin No. 1.)

## 62. DISPATCHING TRAINS.

Add:

NOTE.—Pay of operators who perform station service work also should be charged to account "Station employees."

(For interpretation of this account see Cases 63 and 251, Accounting Bulletin No. 1.)

## 63. STATION EMPLOYEES.

LABOR AT STATIONS.—Add: "Pay of employees tending switch lamps not at terminals. Payments to elevator companies for transferring grain en route; payments to other companies and individuals for loading and unloading sand and other commercial freight under contract or otherwise."

Eliminate the word "yards" in the fourteenth, sixteenth, and seventeenth lines and substitute the word "pens," so that the text will read "stock pens" instead of "stock yards."

NOTE.—Page 65: Eliminate the letter "s" from the word "accounts" in the fourth and fifth lines of the note, and eliminate the words "Stock Yards and Grain Elevators and," so that the note will read, "This account should not include the pay or expenses of telegraph and telephone operators provided for under accounts 'Dispatching Trains' and 'Telegraph and Telephone Operation' or pay and expenses of employees provided for under account 'Coal and Ore Docks,' or those engaged in 'Outside Operations.'"

(For interpretation of this account see Cases 26, 64, 65, 66, 67, 118, 131, 193, 196, 197, 198, 199, 202, 251, 267, and 300, Accounting Bulletin No. 1.)

## 64. WEIGHING AND CAR SERVICE ASSOCIATIONS.

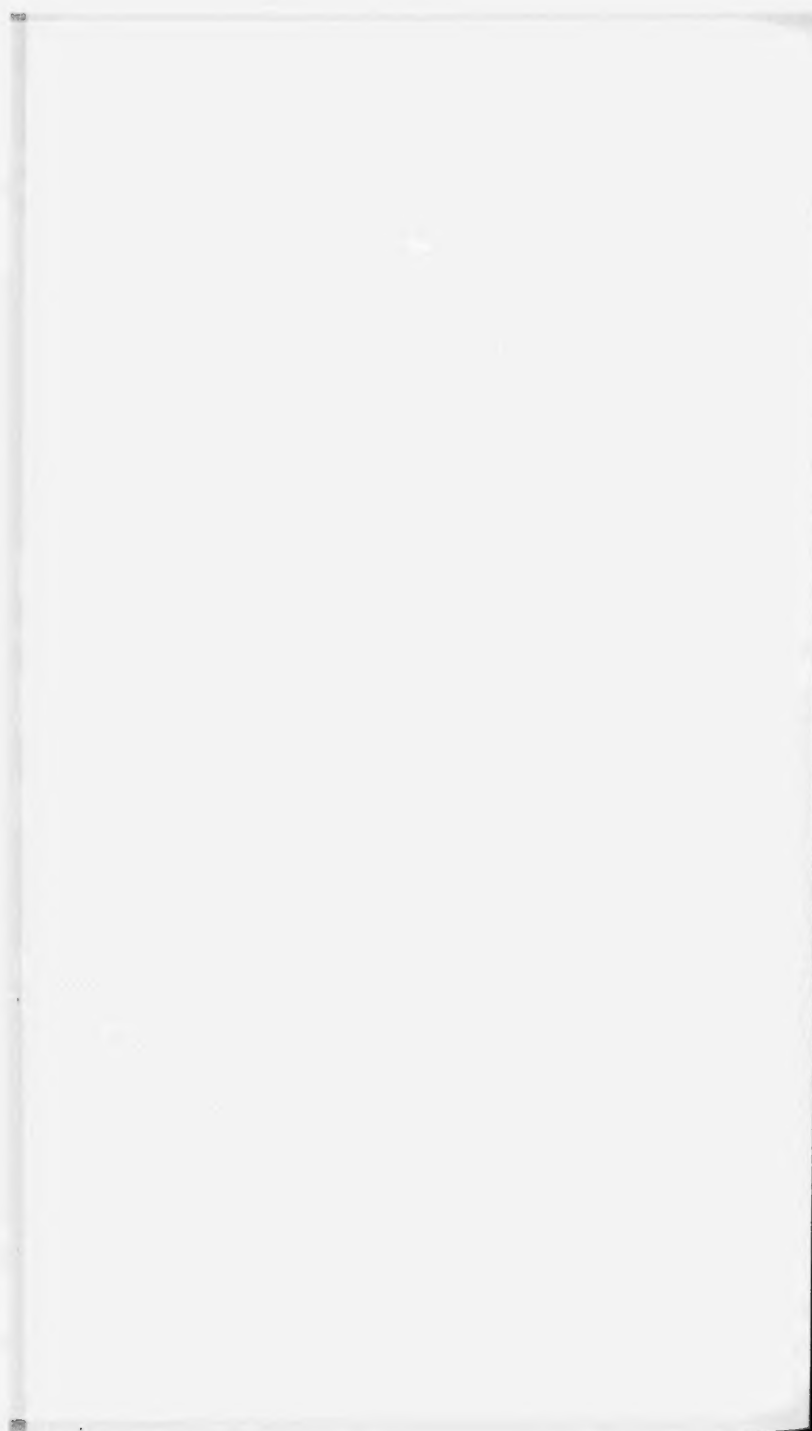
No change.

(For interpretation of this account see Case 301, Accounting Bulletin No. 1.)

## STOCK YARDS AND GRAIN ELEVATORS.

This account is eliminated, all expenses on account thereof to be classified as "Outside Operations."

See Case 67, Accounting Bulletin No. 1





## 65. COAL AND ORE DOCKS.

No change.

(For interpretation of this account see Case 66, Accounting Bulletin No. 1.)

## 66. STATION SUPPLIES AND EXPENSES.

OTHER EXPENSES.—Add: "Supplies for switch lamps at points where no regular switching service is maintained; incidental expenses of station employees."

LIGHTING.—At the end of this paragraph, add: "and passenger foot bridges and subways at stations."

To the list on page 66 add:

Switch keys.

(For interpretation of this account see Cases 67, 68, 197, 205, and 299, Accounting Bulletin No. 1.)

## 67. YARDMASTERS AND THEIR CLERKS.

No change.

(For interpretation of this account see Cases 191 and 202, Accounting Bulletin No. 1.)

## 68. YARD CONDUCTORS AND BRAKEMEN.

No change.

(For interpretation of this account see Cases 69, 71, 72, 191, and 202, Accounting Bulletin No. 1.)

## 69. YARD SWITCH AND SIGNAL TENDERS.

No change.

(For interpretation of this account see Cases 76, 191, 196, and 202, Accounting Bulletin No. 1.)

## 70. YARD SUPPLIES AND EXPENSES.

Add: "Switch keys; Lubricants for yard switches."

(For interpretation of this account see Cases 76, 191, and 299, Accounting Bulletin No. 1.)

## 71. YARD ENGINEMEN.

Add:

NOTE.—When locomotives are engaged in both Road and Yard service, the pay of engine-men should be apportioned between the Road and Yard accounts on the basis of the service rendered. This does not apply to way switching by locomotives and crews in road service, the entire pay of engine-men for which should be charged to Account No. 80, "Road Enginenen."

(For interpretation of this account see Cases 69, 71, 72, 188, 189, 190, 191, and 202, Accounting Bulletin No. 1.)



## 72. ENGINEHOUSE EXPENSES—YARD.

Add: "Pay of hostlers and helpers at roundhouses; rents paid for use of stalls in roundhouses."

In the second line, after the word "callers," insert "(except as provided for in account, 'Yardmasters and their Clerks')."

In the second line eliminate the word "other."

(For interpretation of this account see Cases 163, 202, 203, and 288, Accounting Bulletin No. 1.)

## 73. FUEL FOR YARD LOCOMOTIVES.

In the third line, after the words "fuel agents," insert: "fuel inspectors, weighers."

(For interpretation of this account see Cases 69, 71, 72, 188, and 189, Accounting Bulletin No. 1.)

## 74. WATER FOR YARD LOCOMOTIVES.

Add: "Proportion of pay of superintendent of water service engaged in connection with water supply for locomotives."

Eliminate the note following this account, and in place thereof substitute the following:

*Note.*—The apportionment of cost of water *between yard and road locomotives* should be based on the relative number of tons of coal used on locomotives in yard and road service.

(For interpretation of this account see Cases 69, 71, 72, 188, 189, 191, 201, and 253, Accounting Bulletin No. 1.)

## 75. LUBRICANTS FOR YARD LOCOMOTIVES.

No change.

(For interpretation of this account see Cases 69, 71, 72, 188, and 189, Accounting Bulletin No. 1.)

## 76. OTHER SUPPLIES FOR YARD LOCOMOTIVES.

List, page 70. Eliminate:

Metallie packing.

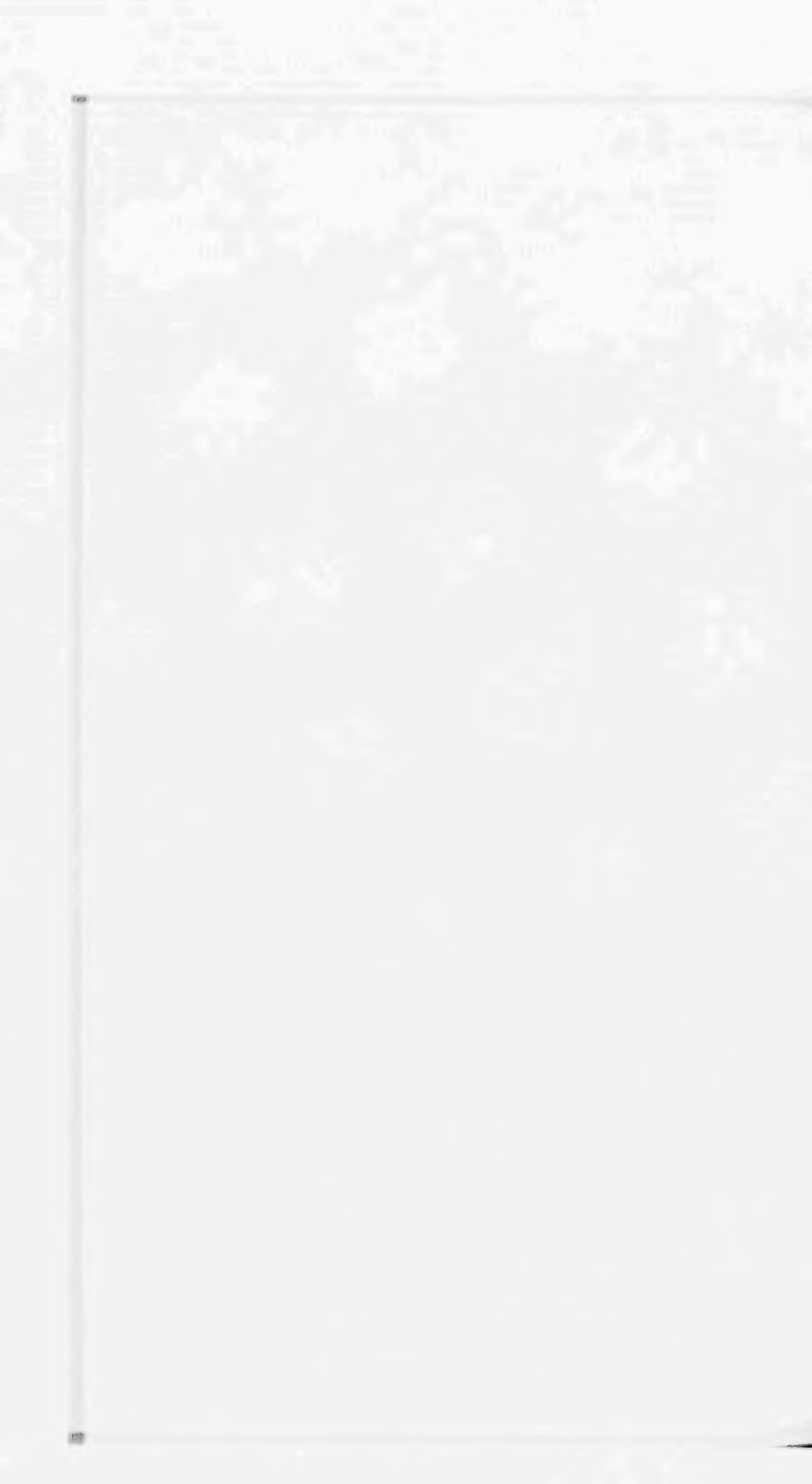
Add:

Switch keys.

Waste.

(For interpretation of this account see Cases 69, 71, 72, 188, 189, 256, and 299, Accounting Bulletin No. 1.)

(For interpretation of Yard Expenses see Cases 69, 71, 72, 76, 163, 188, 189, 190, 191, 192, 194, 196, 203, 256, 288, and 299, Accounting Bulletin No. 1.)



## 77. OPERATING JOINT YARDS AND TERMINALS—DR.

Revise the text of this account to read:

"This account includes a carrier's proportion of costs incurred to operate joint yards and terminals, including interlockers and other facilities at such joint yards and terminals, operated by other companies."

The text of the note remains as at present.

(For interpretation of this account see Cases 117, 118, 161, 275, 283, 284, 285 and 312, Accounting Bulletin No. 1.)

## 78. OPERATING JOINT YARDS AND TERMINALS—CR.

Revise the text of this account to read:

"This account includes the proportion of costs incurred to operate joint yards and terminals, including interlockers and other facilities at such joint yards and terminals, operated by a carrier, chargeable to other carriers."

The text of the note remains as at present.

(For interpretation of this account see Cases 118, 161, 193, 275, 283, 284, 285 and 312, Accounting Bulletin No. 1.)

## 79. MOTORMEN.

Add:

NOTE.—When carriers operating electric divisions desire to subdivide this account, appropriate accounts as presented in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Case 202, Accounting Bulletin No. 1.)

## 80. ROAD ENGINEMEN.

Add:

NOTE B.—When locomotives are engaged in both road and yard service the pay of enginemen should be apportioned between the Road and Yard accounts on the basis of the service rendered. This does not apply to way switching by locomotives and crews in road service, the entire pay for enginemen for which should be charged to this account.

(For interpretation of this account see Cases 54, 69, 71, 72, 73, 188, 189, 190, and 202, Accounting Bulletin No. 1.)

## 81. ENGINEHOUSE EXPENSES—ROAD.

Add: "Pay of hostlers and helpers at roundhouses; rents paid for use of stalls in roundhouses."

In the second line eliminate the word "other."

(For interpretation of this account see Cases 74, 163, 202, 203, and 288, Accounting Bulletin No. 1.)



## 82. FUEL FOR ROAD LOCOMOTIVES.

In the fourth line, after the word "agents," insert: "fuel inspectors, weighers."

(For interpretation of this account see Cases 69, 71, 72, 188, and 189, Accounting Bulletin No. 1.)

## 83. WATER FOR ROAD LOCOMOTIVES.

Add: "Proportion of pay of superintendent of water service engaged in connection with water supply for locomotives."

Eliminate the note following this account and in place thereof substitute the following:

NOTE.—The apportionment of cost of water as between yard and road locomotives should be based on the relative number of tons of coal used on locomotives in yard and road service.

(For interpretation of this account see Cases 69, 71, 72, 74, 188, 189, 191, 201, and 253, Accounting Bulletin No. 1.)

## 84. LUBRICANTS FOR ROAD LOCOMOTIVES.

No change.

(For interpretation of this account see Cases 69, 71, 72, 188, and 189, Accounting Bulletin No. 1.)

## 85. OTHER SUPPLIES FOR ROAD LOCOMOTIVES.

List, page 73: Eliminate:

Metallic Packing.

Add:

Switch Keys.

Waste.

(For interpretation of this account see Cases 69, 71, 72, 75, 188, 189, 256, and 299, Accounting Bulletin No. 1.)

## 86. OPERATING POWER PLANTS.

Add:

NOTE A.—This account includes only the cost of operating power plants for the purpose of furnishing power for the propulsion of electric locomotives, cars, or trains.

NOTE B.—When carriers operating electric divisions desire to subdivide this account, appropriate accounts as prescribed in the Classification of Operating Expenses for Electric Railways should be used.

(For interpretation of this account see Cases 59 and 178, Accounting Bulletin No. 1.)

## 87. PURCHASED POWER.

No change.





## 88. ROAD TRAINMEN.

Add:

NOTE B.—When carriers operating electric trolley cars desire to credit to this account, appropriate account as presented in the classification of operating expenses for electric railroads should be used.

(For interpretation of this account see Cases 69, 71, 72, and 202, Accounting Bulletin No. 1.)

## 89. TRAIN SUPPLIES AND EXPENSES.

EMBRACING CARS.—After the last word in this paragraph add: "except work-train cars."

ICE AND WARMING CARS.—Add: "To this account should be credited refrigeration charges collected from other companies and individuals."

OTHER EXPENSES.—Add: "Cost of removing advertisements from cars."

To the list on page 76 add:

Switch keys.

(For interpretation of this account see Cases 69, 71, 72, 74, 215, 274, 281, 284, and 299, Accounting Bulletin No. 1.)

## INTERLOCKERS, BLOCK AND OTHER SIGNALS—OPERATION.

Change the title of this account to read: "Interlockers and Block and other signals—Operation."

## 90. INTERLOCKERS AND BLOCK AND OTHER SIGNALS—OPERATION.

Add: "Cost of material used and labor expended in installing switches and signals, except those of terminal type."

(For interpretation of this account see Cases 39, 76, 202, and 204, Accounting Bulletin No. 1.)

## 91. CROSSING FLAGMEN AND GATEMEN.

Add: "also amounts paid for electric lights at street crossings not at stations or in yard."

(For interpretation of this account see Cases 202 and 209, Accounting Bulletin No. 1.)

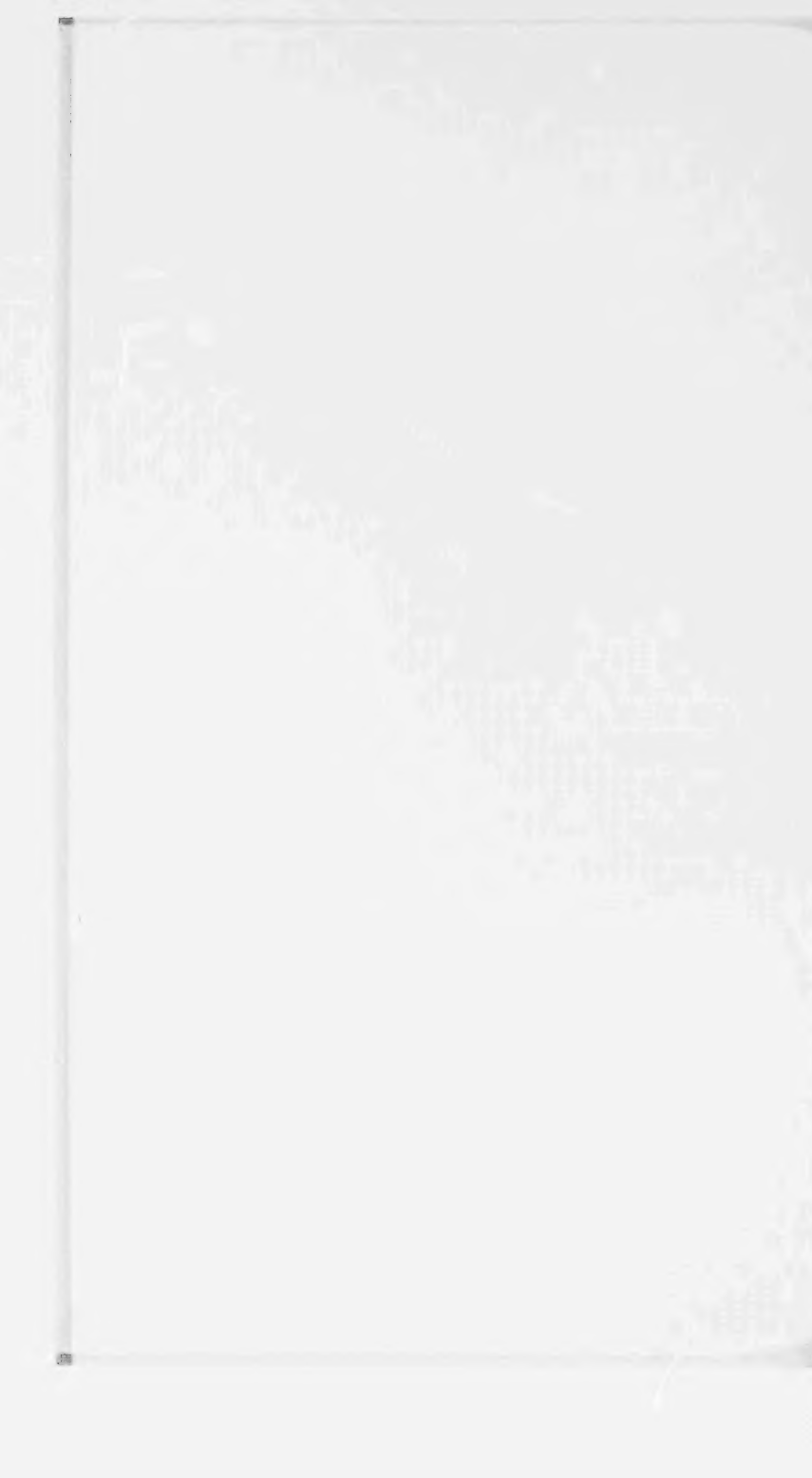
## 92. DRAWBRIDGE OPERATION.

No change.

## 93. CLEARING WRECKS.

TRAIN SERVICE.—Add: "Amounts paid to other companies for use of engines, derricks, other equipment, and crews on wrecking service."

(For interpretation of this account see Cases 54 and 244, Accounting Bulletin No. 1.)



## 94. TELEGRAPH AND TELEPHONE—OPERATION.

OPERATORS AND MESSENGERS.—Eliminate fourth line of this paragraph, consisting of the words "who also perform other station work."

(For interpretation of this account see Cases 43, 95, 198, and 202, Accounting Bulletin No. 1.)

## 95. OPERATING FLOATING EQUIPMENT.

No change.

(For interpretation of this account see Cases 137 and 202, Accounting Bulletin No. 1.)

## 96. EXPRESS SERVICE.

No change.

## 97. STATIONERY AND PRINTING.

No change.

(For interpretation of this account see Cases 154, 155, and 200, Accounting Bulletin No. 1.)

## INSURANCE.

This account is eliminated, cost of all insurance to be charged to primary account No. 110, "Insurance," under general account, "General Expenses."

## 98. OTHER EXPENSES.

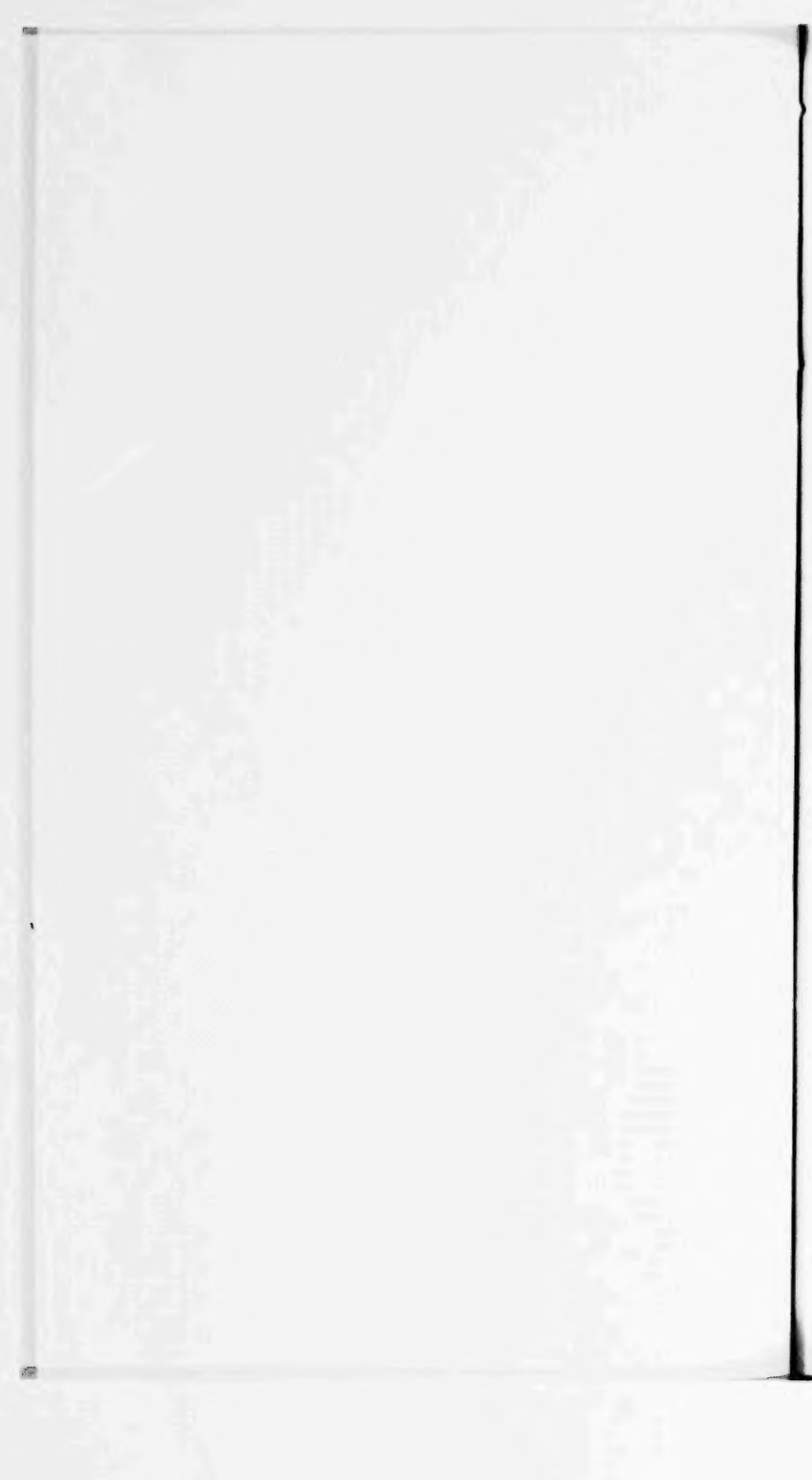
No change.

(For interpretation of this account see Cases 77, 79, 202, 206, 218, and 276, Accounting Bulletin No. 1.)

## 99. LOSS AND DAMAGE—FREIGHT.

Eliminate the words "but not" in parentheses in the third line of the text; eliminate the words "recovered" and "net" in the seventh line of the text, so that it will read:

"This account includes payments for loss, damage, delays, or destruction of freight, locomotives, and cars when waybilled as freight, including all company's material, parcels or express intrusted to the company for transportation, including live stock received for shipment; and all expenses directly incident thereto; freight in transit lost overboard from lighters (less insurance and amount recovered from sale of unclaimed and damaged freight); cost of repacking and boxing damaged merchandise and other property; pay and expenses of employees and others engaged as adjusters and in detecting thieves; and services



and expenses of employees or others while engaged as witnesses in law suits in connection with loss and damage cases."

Add: "Freight charges paid other carriers on lost or damaged shipments."

Add:

NOTE B.—The pay and expenses of claim adjusters, clerks, and others whose pay can not be actually allocated to any case should be divided equally among personal injury and other claims over which they have jurisdiction.

(For interpretation of this account see Cases 4, 8, 155, 279, and 298, Accounting Bulletin No. 1.)

#### 100. LOSS AND DAMAGE—BAGGAGE.

Add:

NOTE B.—The pay and expenses of claim adjusters, clerks, and others whose pay can not be actually allocated to any case should be divided equally among personal injury and other claims over which they have jurisdiction.

(For interpretation of this account see Cases 4 and 155, Accounting Bulletin No. 1.)

#### 101. DAMAGE TO PROPERTY.

No change.

(For interpretation of this account see Cases 4, 38, and 155, Accounting Bulletin No. 1.)

#### 102. DAMAGE TO STOCK ON RIGHT OF WAY.

No change.

(For interpretation of this account see Cases 4 and 155, Accounting Bulletin No. 1.)

#### 103. INJURIES TO PERSONS.

Add: "Pay and expenses of employees and others while attending coroners' inquests or engaged as witnesses in law suits in connection with personal injury cases."

NOTE A.—Eliminate the words "witness fees and other expenses" and substitute in place thereof the words "Expenses not otherwise provided for."

(For interpretation of this account see Cases 4, 34, 78, 155, 164, 165, and 310 Accounting Bulletin No. 1.)

#### OPERATING JOINT TRACKS—DR.

Change the title of this account to "Operating Joint Tracks and Facilities—Dr.", and modify the text to agree with the wording under that title below.

THE UNIVERSITY OF CHICAGO  
LIBRARY  
540 EAST 57TH STREET  
CHICAGO, ILL. 60637

THE UNIVERSITY OF CHICAGO  
LIBRARY  
540 EAST 57TH STREET  
CHICAGO, ILL. 60637

## 104. OPERATING JOINT TRACKS AND FACILITIES—DR.

This account includes a carrier's proportion of transportation expenses incurred in the use of joint tracks, interlockers, and other facilities (except as provided for in account "Operating Joint Yards and Terminals—Dr." operated by other companies).

NOTE. The purpose of this account is to show the amounts accruing against a carrier for its proportion of the expense of operating joint tracks and facilities operated by other companies but in the joint use of which a carrier participates. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

(For interpretation of this account see Cases 118, 268, 286, 295, and 312, Accounting Bulletin No. 1.)

## OPERATING JOINT TRACKS—CR.

Change the title of this account to "Operating Joint Tracks and Facilities—Cr.," and modify the text to agree with the wording under that title below.

## 105. OPERATING JOINT TRACKS AND FACILITIES—CR.

This account includes the proportion of transportation expenses incurred in the use of joint tracks, interlockers, and other facilities (except as provided for in account "Operating Joint Yards and Terminals—Dr."), operated by a carrier, chargeable to other carriers.

NOTE. The purpose of this account is to show the amounts accruing in favor of a carrier against other companies for their proportion of the expense of operating joint tracks and facilities operated by a carrier but in the joint use of which other companies participate. The bill rendered by any creditor against a debtor for the latter's proportion of expense of operation of joint facilities should show the distribution of the total charge among the general accounts as made by the creditor, and such distribution should be adhered to by the debtor.

(For interpretation of this account see Cases 118, 268, 284, 289, 295, and 312, Accounting Bulletin No. 1.)

## V. GENERAL EXPENSES.

## 106. SALARIES AND EXPENSES OF GENERAL OFFICERS.

SALARIES.—Add: "Commissions paid to land and tax commissioners in lieu of salaries."

(For interpretation of this account see Cases 82, 204, 246, 255, and 262, Accounting Bulletin No. 1.)





## 107. SALARIES AND EXPENSES OF CLERKS AND ATTENDANTS.

No change.

(For interpretation of this account see Cases 82, 246, and 262, Accounting Bulletin No. 1.)

## 108. GENERAL OFFICE SUPPLIES AND EXPENSES.

No change.

(For interpretation of this account see Case 35, Accounting Bulletin No. 1.)

## 109. LAW EXPENSES.

Add: "Cost of membership in associations the object of which is to protect roads in respect to litigation concerning the use of patent."

(For interpretation of this account see Cases 287 and 340, Accounting Bulletin No. 1.)

## 110. INSURANCE.

Amend the text to read:

"This account includes all premiums made or paid by a carrier to its insurance agency and premiums, except reinsurance premiums, paid by it to insurance companies for insuring buildings and other structures, equipment of all classes, other property, and persons against loss, damages, or injury by fire, accident, or other causes."

Notes A and B remain as at present.

(For interpretation of this account see Cases 29, 31, and 182, Accounting Bulletin No. 1.)

## 111. RELIEF DEPARTMENT EXPENSES.

No change.

## 112. PENSIONS.

No change.

(For interpretation of this account see Cases 208 and 392, Accounting Bulletin No. 1.)

## 113. STATIONERY AND PRINTING.

No change.

(For interpretation of this account see Cases 154 and 155, Accounting Bulletin No. 1.)



## 114. OTHER EXPENSES.

Add: "Donations to local fire departments; cost of exchange on checks cashed or deposited and drafts bought; cost of draping stations."

(For interpretation of this account see Cases 113, 207, and 313 Accounting Bulletin No. 1.)

## 115. GENERAL ADMINISTRATION JOINT TRACKS, YARDS, AND TERMINALS—DR.

No change.

(For interpretation of this account see Case 295, Accounting Bulletin No. 1.)

## 116. GENERAL ADMINISTRATION JOINT TRACKS, YARDS, AND TERMINALS—CR.

No change.

(For interpretation of this account see Cases 285 and 295, Accounting Bulletin No. 1.)



RECEIVED  
FEB 27 1913  
U.S. DEPT. OF JUSTICE

No. 571

In the Supreme Court of the United States

OCTOBER TERM 1912

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
APPELLANT,

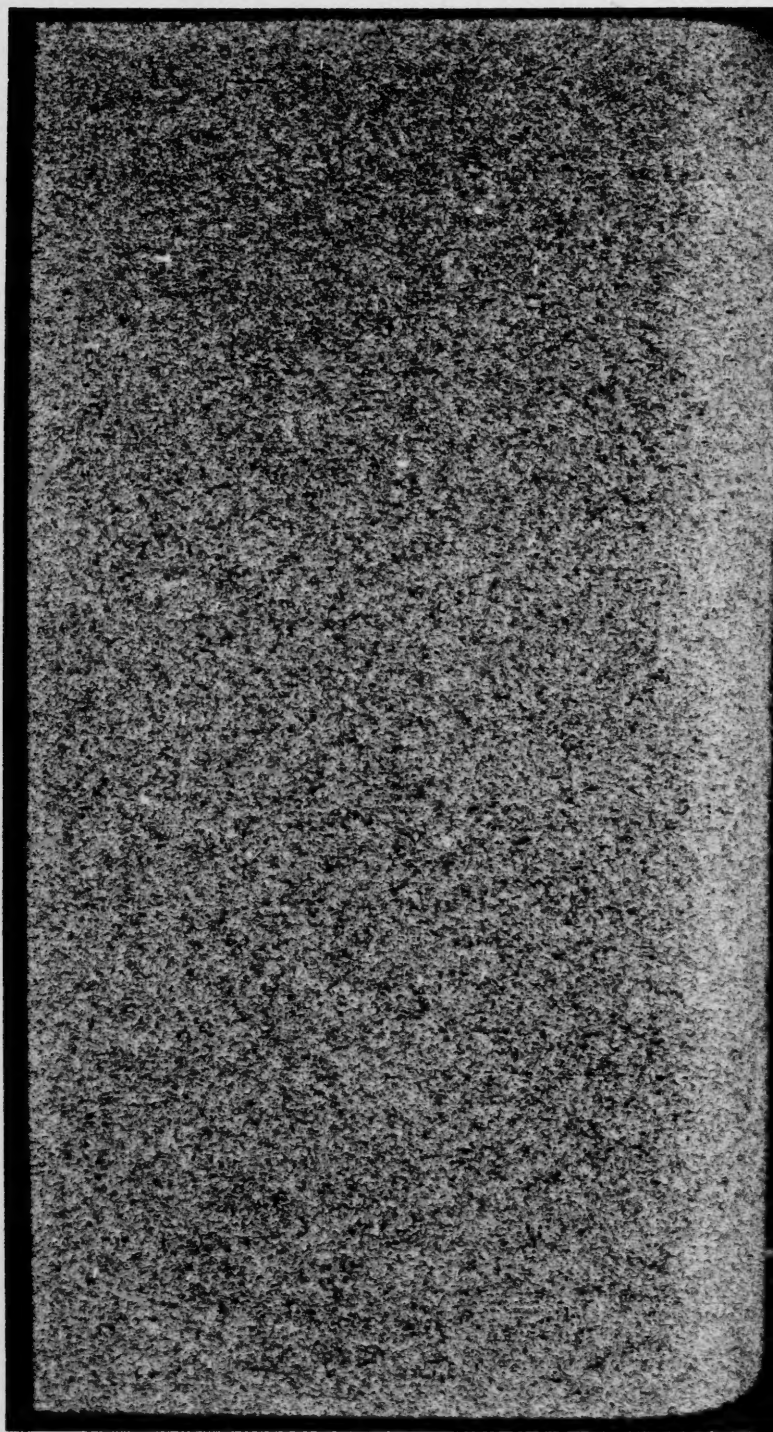
v.

THE UNITED STATES OF AMERICA AND THE INTER-  
STATE COMMERCE COMMISSION, APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT

NOTICE BY THE UNITED STATES TO ADVANCE

PRINTED AND BOUND BY THE UNITED STATES DISTRICT COURT



# In the Supreme Court of the United States.

OCTOBER TERM, 1912.

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THE KANSAS CITY SOUTHERN RAILWAY Company, appellant,	}	No. 1142.
THE UNITED STATES OF AMERICA AND the Interstate Commerce Commission, appellees.		

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*APPEAL FROM THE UNITED STATES COMMERCE COURT.*

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## **MOTION BY THE UNITED STATES TO ADVANCE.**

Comes now the Attorney General on behalf of the United States and moves the court to advance the above-entitled cause for hearing at the beginning of next term.

The priority suggested is authorized by section 2 of the Commerce Court act of June 18, 1910 (36 Stat. L., Part I, c. 309, p. 542).

The appeal is from a final judgment dismissing the petition, which sought to set aside an order of the Commission prescribing a uniform system of accounting under section 20 of the act to regulate commerce. Pending disposition of this appeal certain items of the

appellant's accounts are held in a suspense account, with the consent of the Commission.

Counsel for the appellant and counsel for the Commerce Commission concur in this motion.

JAS. C. McREYNOLDS,

*Attorney General.*

WINFRED T. DENISON,

*Assistant Attorney General.*

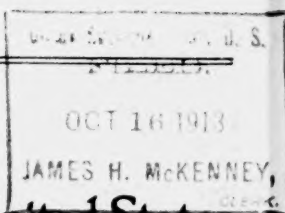
MAY 26, 1913.





IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1913.  
No. 571.



THE KANSAS CITY SOUTHERN RAILWAY  
COMPANY,

*Appellant,*

*against*

THE UNITED STATES OF AMERICA,

*Respondent,*

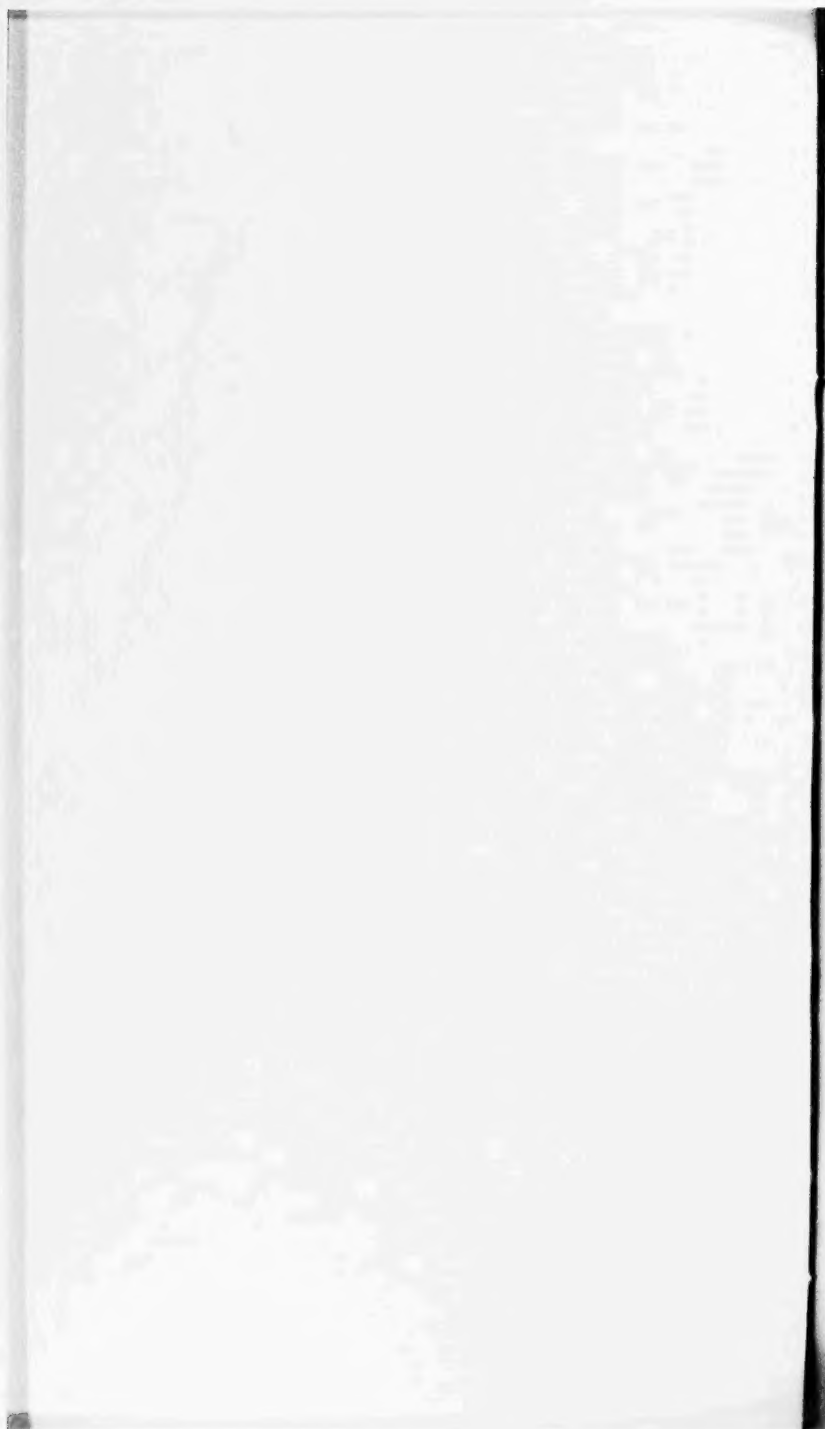
INTERSTATE COMMERCE COMMISSION,

*Intervening Respondent.*

**APPELLANT'S BRIEF.**

SAMUEL UNTERMYER,  
WALTER C. NOYES,  
ARTHUR M. WICKWIRE,  
IRWIN UNTERMYER,

*Solicitors for Appellant*



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IN THE  
**Supreme Court of the United States.**

THE KANSAS CITY SOUTHERN  
RAILWAY COMPANY,  
Appellant,

*against*

THE UNITED STATES OF AMERICA,  
Respondent,  
INTERSTATE COMMERCE COMMISSION,  
Intervening Respondent.

**APPELLANT'S BRIEF.**

**The Case in General.**

This is an appeal from the decree of the United States Commerce Court dismissing the appellant's petition in an action brought to have certain regulations of the Interstate Commerce Commission relative to the method of keeping the accounts of carriers declared invalid and to enjoin the enforcement thereof. The regulations are contained in the "Classification of Expenditures for Additions and Betterments of Steam Roads," effective July 1st, 1909, and a Revision thereof.

The ostensible purpose of these Regulations is to prescribe the "form" of the Petitioner's accounts. The fundamental question for determination is whether under the guise of prescribing the "form" the Commission may control the administration of the Company's affairs in matters not otherwise within its authority.

### **Statement of Facts.**

#### *The Improvements made by the Petitioner and the Reasons Therefor.*

The Petitioner is engaged in interstate commerce. Its main line is about 786 miles in length and extends from Kansas City to Port Arthur, on the Gulf of Mexico, traversing the States of Missouri, Kansas, Oklahoma, Arkansas, Louisiana and Texas. (*Testimony*, p. 2.)

The road was built years ago, when the country was heavily timbered and sparsely settled, and the traffic was correspondingly small. (*Testimony*, p. 46.)

The traffic would not support, nor could capital be obtained for, an expensively constructed road; and in consonance with the general practice in the development of the country, the road was built with rather heavy ruling grades. (*Testimony*, p. 109.) But the road was not defectively or improperly constructed or located; it had substantially the same grades as other roads then constructed in the west; and it was adequate to serve the then existing needs of the country. (*Testimony*, pp. 46-47.)

A railroad with heavy grades is, of course, more cheaply constructed than a road of low

grade. And a road of heavy grades is generally adequate in a new country, where the volume of traffic offered is small, the train-loads light, and the trains few. Consequently in a new country economy precludes the construction of new railroads having other than heavy grades. (*Testimony*, p. 110).

The ruling maximum grade of the line as originally constructed was 1 per cent; and in the mountain district as high as 1.35 per cent. (*Testimony*, pp. 15-16). The evidence is undisputed that it was properly located, well constructed, and ample for the needs of the country (See the testimony of Mr. Lorce, the chairman of the board, *Testimony*, p. 46; and of Mr. Johnston, chief engineer, *Testimony*, pp. 109, 110).

In the course of time, with the great development of the country and the resultant increase in traffic whereby the limit of the road's capacity was being approached, the conditions warranted and rendered highly desirable such additions or improvements as would enlarge the road's capacity, and permit traffic to be moved more rapidly and economically.

Two methods of increasing the capacity of the road were presented; one by double-tracking the road, the other by lowering the grades and thus permitting traffic to be moved more rapidly. The road was in active competition with powerful rivals operating in the same general territory. Among these were the Southern Pacific, the Missouri, Kansas and Texas, the Missouri Pacific, the St. Louis Southwestern, the Texas and Pacific, the St. Louis and San Francisco, the Atchison, Topeka and Santa Fe, and the Rock Island (*Testimony*, p. 3). The charac-

ter of the road as a trunk line, having a long average haul and the prevalence of low class traffic,—timber, coal, oil and like commodities—necessarily entailed a low average freight rate (*Testimony*, pp. 3-4). Its average rates per ton per mile are lower than those of any of its competitors above named (*Testimony*, p. 15).

Under these conditions the management found that the most desirable plan was to lower the grades of the road, and thus to increase its capacity, procure economy in operation, and render better service to the public (*Testimony*, p. 13). In this conclusion they were supported by the advice of Mr. Loree and Mr. Horace G. Burt—railroad engineers and experts of the highest standing. Mr. Loree was Chairman of the Board of Directors of the Petitioner, and President of the Delaware and Hudson Company (*Testimony*, p. 2); Mr. Burt was formerly President of the Union Pacific (*Testimony*, p. 4).

Mr. Burt, with the aid of an engineering staff, spent about one year and \$150,000 in an exhaustive examination of the physical conditions of the Petitioner's road, and prepared an elaborate report (*Testimony*, p. 4). The principal recommendation of this report, in which Mr. Loree and the management fully concurred, was an extensive program of grade reduction to an ultimate line having a maximum grade of five-tenths of 1 per cent. in both directions (*Testimony*, pp. 15-16).

Two methods of reducing the grades at various points along the line were presented: one by raising or lowering the roadbed on the existing right of way; the other by the construction of short sections of new road in substitution for portions of the road, in instances where the same result

(*Testimony*, pp. 46-47.)

could be thus obtained *at less cost* (*Testimony, pp. 32-34*).

It is important to observe that the changing of occasional locations does not in any way indicate that the original locations were mistakenly or unwisely made, for it is well recognized that the survey of a 1 per cent. line will not coincide, except at occasional stretches, with a five-tenths of 1 per cent. line. As Mr. Loree testified: "You have to find entirely different supporting ground for the one grade than for the other." (*Testimony, p. 47.*) Mr. Johnston, the chief engineer, testified (*Testimony, page 109*):

"Q. Will the line of a railroad constructed at a maximum grade of one per cent coincide with the survey of a railroad having a maximum of one-half of one per cent? A. No, sir; it is not practicable to locate a five-tenths per cent line on a one per cent location.

Q. If a survey is made for the purpose of locating a railroad having a five-tenths per cent grade, different supporting ground is chosen from what would be chosen for a one per cent maximum grade? A. Yes, sir.

Q. You are familiar with the location of this road. Will you state whether in your judgment it was properly located at a one per cent maximum grade, or approximately that, at the time it was built? A. Yes, sir; I think the location of the old line of the Kansas City Southern, upon the basis they were working, was done exceedingly well. In fact, we found but very few instances where we could have made an improvement under the same basis.

Q. So that the location, in your judgment, was in no way a mistake? A. I do not think so."

The program of improvement naturally contemplated, therefore, not only many changes on the original right of way, but also a number of changes by the substitution of short sections of road on new ground, wherever that method was more economical.

The first six sections of the road where new locations were utilized are covered by the Petition. Other similar changes are being made, as the work proceeds, which will cover several years (*Testimony*, pp. 41-112), and is estimated to cost \$3,000,000 (*Testimony*, p. 60). The road at these six points was in no way worn out, was fully maintained, and was capable of performing for an indefinite term the function for which it was originally constructed (*Testimony*, pp. 46-108). All of these changes are made for the sole purpose of increasing the capacity of the line, of securing economy in operation, and of rendering improved service to the public. (*Testimony*, pp. 43-108).

At the six sections of the road in question it was found by the estimates of the engineers that the cost of securing the required gradient *upon the original roadbed* would be \$1,230,318.99; but that the same result could be obtained *by means of re-locations upon adjacent land* for a net expenditure of \$629,399.74—practically one-half.

The actual expenditure on these six new locations, as ascertained on completion of the work (after the filing of the Petition) was \$763,798; and the testimony shows that had the work been done *on the original roadbed* the cost would have been increased over the estimates in an equal or greater proportion. This variation was due to increase in the cost of labor, materials, &c. For the purposes of this brief and for clearness in referring to the allegations in the Petition, we shall

use the figures set forth in the Petition, which are therein carefully worked out in detail. (*Testimony*, p. 105.)

The grade revisions at the six sections of line involved herein having been completed by removing the tracks to adjacent parcels of ground, which were procured and substituted for the original parcels, the use of the latter parcels was, of course, discontinued.

Furthermore, the expenditure of \$763,798 has greatly increased the efficiency of the road and has added at least that much value to it. On this point the evidence is undisputed (*Testimony*, p. 46).

Mr. Lorce testified (*Testimony*, p. 48):

“Q. Is it your opinion that the line of railroad, considered as a unit, has been enhanced to a sum equal to at least the cost of these improvements? A. Yes, sir.

Q. But for that you would not have made these improvements? A. That is correct.”

Mr. Johnston testified to the same effect (*Testimony*, p. 111).

#### *The financing of the Improvements.*

The expenditure required to improve the property by bringing it to the desired grade of five-tenths of one per cent being, as indicated above, a capital expenditure, the Petitioner's directors determined to finance the work by applying to it the proceeds of a bond issue. Indeed, it was necessary to finance the improvements in this way if they were to be made at all, for the Petitioner did not have current earnings available for these improvements, and it could not have financed its pro-

gram, involving as it did the revision of about forty-one per cent of the entire line and an ultimate expenditure of several million dollars (*Testimony, p. 39*) in any other way than by raising capital for that purpose through the issuance of bonds (*Testimony, p. 40*).

Mr. Loree testified (*Testimony, p. 39*):

“Q. Did the Company have current earnings that were available for this improvement, with the other improvements that they have already applied them to? A. They did not.”

Furthermore, even by the issuance of bonds the Company could not have borne the expenditure required for these improvements except through the more economical method of making certain revisions by re-locations off the line of the road. Upon this point, Mr. Loree testified (*Testimony, p. 39*):

“Q. Would it have been possible to have borrowed the money with which to have brought about these improvements on the more expensive method of doing the whole thing on the old line?

(Colloquy between counsel.)

Q. Am I right about that, Mr. Loree? A. You are.”

The Petitioner needed funds for this and certain other purposes and therefore made an issue of bonds secured by a second mortgage on its property. The issuance of these bonds was duly authorized by the directors and stockholders; a portion of the bonds were sold and an initial sum of \$1,250,000 was obtained applicable to the improvements referred to in the Petition and other



improvements in the grade. Additional bonds have since been issued as the work has proceeded (*Testimony*, pp. 41-42).

In 1907 the Petitioner began the payment of dividends at the rate of 4% per annum upon its preferred stock, the total amount of which was \$21,000,000, and has continued to pay such dividends each year until the present time. These dividends are *non-cumulative* and are payable *only out of the earnings of the current year* (*Testimony*, pp. 35, 156).

The fact that the Petitioner had paid its dividend for several years was a vital factor in its credit. These preferred dividends having been established, their discontinuance at any time would have affected the credit of the road so disastrously that it would have been unable except on prohibitive terms to dispose of additional bonds as further money was required from time to time during the progress of the work (*Testimony*, pp. 61, 62).

It will thus be seen that the Petitioner was able to finance its improvements only out of the proceeds of a bond issue; that it could not have financed them except by the more economical method of making a considerable part of the grade reductions by means of changes off the line of the right of way; and that the maintenance of the preferred dividend was essential in order that the additional bonds might be marketed without undue loss as the work progressed.

Apart from considerations affecting the dividend on its preferred stock the testimony shows that the demand for and market price of a carrier's stocks and bonds, and therefore its credit,

depend in large measure upon the margin of income above the sum necessary to defray operating expenses, taxes, interest, etc. Any substantial reduction in that margin would affect the Petitioner's credit injuriously and limit its ability to finance improvements and extensions.

*The Commission's Regulations as to the method of recording these transactions in the Petitioner's books of account.*

The Petitioner having paid the full cost of these six improvements out of its issue of bonds, as it was legally authorized to do, was confronted with the regulations of the Commission bearing on the method of recording the transaction in its books of account.

Prior to the promulgation of these regulations, and from time immemorial, the transaction would have been entered exactly in accord with the facts. The full cost of the improvements would have been charged to the account of "Additions and Betterments"—a subdivision of the property accounts—and credited to the proceeds of the Bonds. Why charged to Additions and Betterments? Because that sum had been expended for additions and betterments. Why credited to the proceeds of the bonds? Because the bonds had supplied every dollar of the funds. In the balance sheet the "Assets" would have shown an increment of approximately \$629,399 under the subdivision of Additions and Betterments, and, *per contra*, the "Liabilities" would have shown a corresponding increase under the subdivision of Bonds.

Under the regulations in question, it was found that if the improvements had been made *on the*

*original right of way*, even though made at double the expense, the entries would have been made exactly as above indicated. But, with respect to improvements made *off the right of way*, wholly different and revolutionary treatment was prescribed. Here the Petitioner was not permitted to carry into its property accounts the full cost of the improvement, but was required first to deduct from the cost thereof the estimated replacement cost of the portions of track no longer used, but "abandoned," to use the language of the regulations, the difference only being carried into the property accounts; and a sum equal to the estimated cost of replacing the old sections of track was to be charged *to the operating expenses of that year* (Petition, fols. 38, 45, 46).

The text of the Classification of Additions and Betterments relative to revisions made *on the original line* is as follows (Petition, fol. 45):

"Grade Revisions. — (Reduction of grades by cutting down summits and raising sags without materially changing the alinement). The amount to be charged to this account is the cost of additional grading done, including as a portion of such cost the rent and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools, etc., used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, and streets, including crossing gates, highway crossing alarms, and watch houses."

Thus it appears that substantially the entire cost of revisions made *on the original line* are to be charged to the Property accounts.

The text of the Classification relative to changes *off the original line* is as follows (Petition, fol. 47):

"Changes of Line. — (Construction of new lines for the purpose of improving grade or alinement). The amount to be charged to this account is the difference between the cost of the new line and the cost of replacing in kind the line abandoned, exclusive of right of way."

The General Instructions contained in the Classification supplement the last mentioned rule and prescribe a charge to Operating Expenses, as follows (Petition, fol. 38):

"5. In case it becomes necessary directly in connection with betterment or improvement work to abandon any property, the cost of replacing the abandoned property in kind, plus the cost of removal but less the value of salvage, should be charged to the appropriate accounts under Operating Expenses."

Applying these regulations to the improvements in question, it was found that, had the six revisions been made upon the original roadbed, substantially the entire expenditure therefor, amounting to approximately \$1,230,318.99, would have been chargeable to the property account. But, because the changes had been made, not merely *vertically* but also *laterally*, the same result being attained at substantially one-half the expenditure, the Petitioner was prohibited from adding the entire cost of the improvements to its

property account. It was found that \$482,953 represented the estimated cost of replacing the discontinued portions of the line; and that the salvage amounted to \$96,469, the difference being \$386,484. The regulations<sup>1</sup> required that this sum of \$386,484 must be deducted from the total cost, leaving a net amount of only \$242,915.74 chargeable to Additions and Betterments; and that this sum of \$386,484 must be charged to *the current expenses of operation*; and this, notwithstanding the fact (as Mr. Adams, the chief witness for the Interstate Commerce Commission admitted) *that no portion of that amount is an expense.* (*Testimony*, p. 101.)

These regulations inevitably produce the following results of which the Petitioner complains as constituting a substantial injury to the enjoyment and control over its property:

1. They reduce the amount of net earnings applicable to dividends, and under the circumstances of this case would cause an irreparable loss to the preferred stockholders. The dividends upon the preferred stock of the Petitioner are *non-cumulative*, and are payable *only out of the income of the current year*. The amount required annually to pay this dividend is \$840,000 (*Testimony*, p. 119). The net income of the Petitioner for the year ending June 30, 1912, without the deduction of \$386,484, as required by the Regulations, was \$885,950.16 (*Testimony*, p. 159)—only about \$45,000 in excess of the div-

(<sup>1</sup>) There is an item of Eight thousand one hundred and sixty-eight dollars (\$8,168), representing the cost of the old right of way, which, under the regulations, is chargeable to Profit and Loss. But substantially the entire amount (less salvage) is chargeable to Operating Expenses, and, for the sake of simplicity in our discussion, we shall hereafter disregard this negligible item.

idend requirement. If the sum of \$386,484 had been charged to operating expenses, the net income would be about one-half the amount necessary to pay the preferred dividend. The passing of the dividend in whole or in part would have entailed an irretrievable loss upon the preferred stockholders aside from the injury resulting to the financial credit of the Petitioner.

2. The property account becomes inaccurate; for the Petitioner has actually expended \$629,399.74 in the improvement of its property, and is entitled, and is in duty bound, to show this full amount in its property account as an accretion thereto. Unless this is permitted, the accounts will declare to the stockholders and to the public that the bonded indebtedness of the Petitioner has been increased to the amount of \$629,399.74, but that, for this expenditure, the company has obtained a net accretion to its property of only \$234,747.74.

3. The operating expense account will be unduly swollen by the wrongful inclusion therein of the sum of \$386,484. Everyone interested in a railroad company's business looks to the net earnings and to the ratio of operating expenses to make a comparison with prior years and to draw inferences as to the success or non-success of the year's operations.

If into the operating expense account there is foisted a huge item which is not an operating expense at all, the net earnings for the year will appear to be greatly reduced, if not wholly wiped out; and thus the accounts of operating expenses become a delusion and a snare, wholly misleading and worse than useless. The stockholders are deceived; the investing public is deceived; and

the financial credit of the railroad company is impaired and its ability to finance its bonds or other obligations destroyed.

4. Nor is this all. Since, under the regulations of the Commission, this sum of \$386,484 cannot be charged to and finally taken out of the proceeds of the bonds but must be charged to operating expenses and thus taken from operating revenue, it follows that this amount, which has already been paid out of the proceeds of bonds, *must ultimately be returned in cash to the bond account*. In other words, it becomes in effect only a loan or temporary advance from the bond account, and, since it is finally taken out of the operating revenue, it must be *returned to the bond account*.

It is to be borne in mind that the subject matter of this proceeding embraces a small portion only of a comprehensive plan of improvement. If the petitioner could be compelled to charge the sum here involved to its operating expenses, and hence, in effect, be prohibited from making the improvements out of the proceeds of bonds, it might, unless it abandoned its plan of improvement, be compelled to charge millions more to operating expenses. This would paralyze the improvements,—to the injury of the Company and the region it serves.

There can be no possible question of the right of the Petitioner to borrow money by the issuance of bonds and to apply it to the making of permanent improvements. The Commission's regulations, however, operate as a direct veto upon the action of the directors and stockholders, who, in the exercise of their discretion and under due authority of law have de-

terminated to make these improvements and to pay for them in this manner. The regulations, therefore, do not simply define the method of keeping the accounts; they affect the internal management of the corporation and prohibit it from carrying out a perfectly lawful transaction.

Second Cause of Action.

The petition also sets forth a second ground of complaint. As an integral part of its program of interrelated improvements the Petitioner is engaged in erecting a new and enlarged shop and terminal plant at Shreveport, on a different location from that of the shop and terminal plant now existing, which are incidentally to be abandoned. This shop and equipment are not worn out or obsolete, but are in good condition and capable with ordinary running repairs of performing for an indefinite term the functions for which they were originally constructed.

The undisputed testimony shows that the property of the Petitioner will be increased by reason of the construction of the new shop and terminal plant in an amount not less than the sum to be expended therefor (*Testimony, p. 112*). But the Petitioner, in the exercise of reasonable discretion, desires to charge the estimated value of the shop and terminal plant, amounting approximately to \$100,000, against its accumulated surplus, as represented in its profit and loss account. The above mentioned regulations of the Commission, however, prohibit the Petitioner from so charging this amount, and require that the estimated replacement cost (less salvage) of the shop and terminal plant now existing shall also be



*charged to the Petitioner's operating expense accounts.*

The disastrous effects of charging this amount of \$100,000 to operating expenses will be equally manifest in respect of this new shop and terminal plant.

As grounds for reversal, reliance is placed upon the following

*Assignments of Error.*

I.

The Court erred in holding that the regulation of the Interstate Commerce Commission, embodied in its order dated June 21, 1909 and effective July 1, 1909, and the Classification of Expenditures for Additions and Betterments for Steam Roads therein referred to, whereby common carriers are required, where portions of the line are discontinued or "abandoned" as an incident to the revision of the grades of the road, to charge the estimated cost of replacing in kind the discontinued or "abandoned" portions of line to Operating Expenses, —was a valid exercise of power on the part of the Commission.

II.

The Court erred in holding that the Interstate Commerce Commission had power to compel the Petitioner to charge to Operating Expenses the estimated cost or value of portions of its line discontinued or "abandoned" as an incident to the revision of its grades; whereas the undisputed evidence showed that such item or items were not an Operating Expense.

## III.

The Court erred in holding that the regulation of the Interstate Commerce Commission, embodied in its said orders and Classification whereby common carriers are required, where portions of their property are discontinued or "abandoned" as an incident to improvement, to charge the estimated cost of replacing in kind the discontinued or "abandoned" property to Operating Expenses—was a valid exercise of power on the part of the Commission.

## IV.

The Court erred in holding that the enforcement of said regulations would not result in taking the Petitioner's property without due process of law.

## V.

The Court erred in holding that the enforcement of said regulations would not result in taking the property of the Petitioner's preferred stockholders without due process of law.

## VI.

The Court erred in holding that said regulations were not an arbitrary or unreasonable exercise of power.

## VII.

The Court erred in failing to hold that the promulgation of said regulations was an exertion of

authority manifested in such an unreasonable manner as to be outside the power and authority of the Interstate Commerce Commission.

#### VIII.

The Court erred in failing to hold that said regulations of the Commission, if enforced, would result in undue and unlawful interference with the Petitioner, its stockholders and directors in respect to the conduct of the internal management of the Petitioner's affairs.

#### IX.

The Court erred in failing to hold that said regulations of the Commission, if enforced, would result in undue and unlawful interference with and usurpation of the functions of the directors of the Petitioner in the internal management of its affairs.

#### X.

The Court erred in holding that the Petitioner did not have the right to charge the estimated cost or value of property discontinued or "abandoned" in connection with improving its facilities against its accumulated surplus as represented in its profit and loss account.

#### XI.

The Court erred in holding that "as to mere bookkeeping this Court has no power or authority to interfere with the orders of the Interstate Commerce Commission."

## XII.

The Court erred in holding that there was sufficient evidence in the record to show that the method of accounting required by the orders of the Commission was a proper and correct one.

## XIII.

The Court erred in holding that it was not within its power to determine whether the Petitioner had the right to charge off the cost or value of discontinued or "abandoned" property to profit and loss account.

## XIV.

The Court erred in holding that no person, with the proper explanatory notes in connection with the entries required to be made by the regulations above referred to would be in any way deceived thereby.

## XV.

The Court erred in ordering that the petition be dismissed.

## XVI.

The Court erred in failing to hold that the Petitioner's property as a whole was increased in value by the improvements in reduction of grades involving changes of line to the extent at least of the expenditures made for such improvements.

## XVII.

The Court erred in failing to hold that the Petitioner's property as a whole was increased in value by the improvements to its shops and terminal plant at Shreveport, Louisiana, to the extent at least of the expenditures made for such improvements.

## XVIII.

The Court erred in failing to hold that the expenditures made by the Petitioner in improving the grades of its line should be entered in the Petitioner's Capital Account in order properly to represent the transaction.

## POINT I.

**The power delegated to the Commission to prescribe the "form" of accounts cannot be extended so as to authorize the exercise of substantial powers of railway management not otherwise within its authority.**

*The scope of the power delegated to the Commission.*

The authority of the Commission rests upon that portion of Section 20 of the "Act to Regulate Commerce," as amended, in 1906, which reads as follows:

"That the Commission is hereby authorized to require annual reports from all common carriers subject to the provisions of this Act, and from the owners of all railroads engaged in interstate commerce as defined in this Act; to prescribe the manner in which such reports shall be made, and to require from such carriers specific answers to all questions upon which the Commission may need information. *Such annual reports shall show in detail the amount of capital stock issued, the amounts paid therefor, and the manner of payment for the same; the dividends paid, the surplus fund, if any, and the number of stockholders; the funded and floating debts and the interest paid thereon; the cost and value of the carrier's property, franchises, and equipments; \* \* \* the amounts expended for improvements each year, how expended, and the character of such improvements; the earnings and receipts from each branch of business and from all sources; the operating and other expenses; the balance of profit and loss; and a complete exhibit of the financial operations of the carrier each year, including an annual balance sheet. Such reports shall also contain such information in relation to rates or regulations concerning fares or freights, or agreements, arrangements, or contracts affecting the same as the Commission may require; and the Commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this Act, prescribe a period of time within which all common carriers subject to the provisions of this Act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept.*"

By an amendment of 1906—known as the *Hepburn Act*—the following provisions were added:

"The Commission shall at all times have access to all accounts, records, and memoranda kept by carriers subject to this Act, and *it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission* and it may employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records and memoranda kept by such carriers. This provision shall apply to receivers of carriers and operating trustees."

"The Commission may, in its discretion prescribe *the forms* of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movement of traffic as well as the receipts and expenditures of money."

Section 20 in its essence grants power to the Commission to do two things: first, to require carriers to return annual reports under oath; and second, to prescribe the "forms" of their accounts.

An analysis of the terms of Section 20 must lead to the conclusion that the grant of authority to the Commission respecting the keeping of accounts is limited to the determination of matters of form and does not authorize the Commission to exercise any control over the corporation in its relation to its stockholders. By way of illustration, the power granted to the Commission might be exercised to prescribe a uniform schedule to be used by the carrier in preparing its accounts. It might be exercised to subdivide the Capital Account or the Operating Expenses into

their component parts. In fact, the power might be exercised upon any subject which is properly within the scope of the authority to determine the form. But there must of necessity be limits beyond which this power cannot go. It cannot interfere with the conduct of the Company's business in its relations to its stockholders or creditors. It cannot control the payment of dividends. It cannot determine in what manner or from what source the Company shall procure funds for the improvement of its property. That it cannot accomplish any of these results by direct action, will not be denied. But it is said that by virtue of its power to prescribe the forms of accounts it may accomplish indirectly the very result which it is conceded may not be accomplished directly. In other words, that the power to prescribe *the form* involves the power to control *the substance*.

Our argument is based upon the express terms of the Act. The power granted to the Commission is to prescribe the *forms* of accounts and the basis of our contention is that there should be a recognition of the distinction between *form* and *substance*. To the end of standardizing railroad accounts and of enabling the Commission to obtain full and accurate information concerning the affairs of each corporation, it should undoubtedly have power to require any reports, schedules and accounts necessary to show the true financial condition of each carrier. No limitations are placed upon the particularity of the statements which may be demanded. Indeed it may be conceded that power to prescribe the form of accounts includes the power to make such regulations concerning them as may be necessary up to the point where the regulation in its essence goes not to



the form but to the substance, and involves interference with the internal affairs of the corporation.

If the grant of power to prescribe the form of accounts stood alone, it might even be construed as authorizing the Commission to allocate items as it saw fit, and it might be contended that such regulation had for its object public information only and did not affect the corporation in the administration of its internal affairs. The difficulty with this argument is that the prescribed method of accounting *is the only lawful method*, and when the rights of a corporation in its internal or external affairs depend upon its accounts they must necessarily depend upon its lawful accounts.

This interpretation of the Statute would not interfere in any way with the work of the Commission as a public administrative tribunal. The Commission would have full power to require from the carriers detailed schedules of every kind of expenditure or receipt and to rearrange them as it might see fit. So far as the public is concerned, the result would be precisely the same as it is now. The only difference would be that the carriers would not themselves be compelled to allocate items in the only accounts which they are permitted to keep and thereby in effect be precluded in the determination of matters which are concededly beyond the jurisdiction of the Commission.

This conclusion is fortified by a comparison of Section 6, relating to rate schedules, and Section 20 of the Act:

*Sec. 30 Extract.*

*"The Commission may determine and prescribe the form in which the schedules required by this section to be kept open to public inspection shall be prepared and arranged and may change the form from time to time as shall be found expedient."*

*Sec. 30 Extract.*

*"The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movement of traffic as well as the receipts and expenditures of money."*

These grants of power, expressed in almost identical terms, have a similar purpose—to obtain information for the public benefit. Yet it has never been contended that the power to prescribe the form in which the schedules of rates should be prepared and arranged involved the power, by any arrangement of the schedules, to prescribe the rates or to interfere with the internal affairs of the carriers. It required the whole of Section 15, repeatedly revised and amplified, to accomplish that.

Had it been the purpose of Congress to grant authority to the Commission to control the substance of the matters recorded in the accounts, much broader and more comprehensive language would have been used. The phraseology would not have been limited to authorizing the Commission to prescribe the "*forms*" of accounts and "*the manner* in which such accounts shall be kept."

In *Texas & Pacific Railway Company v. Interstate Commerce Commission*, 162 U. S., 197, the court held that an order of the Commission depriving inland consumers of the advantage of through rates and thus giving advantage to the traders and manufacturers of the large seaboard cities seemed to create the very mischief which it was one of the objects of the Commission to remedy. Mr. Justice Shiras, writing the opinion of the court, said:

"Subject to the two leading prohibitions that their charges shall not be unjust or unreasonable, and that they shall not unjustly discriminate, so as to give undue preference or advantage, or subject to undue prejudice or disadvantage persons or traffic similarly circumstanced, the act to regulate commerce leaves common carriers as they were at the common law, free to make special contracts looking to the increase of their business, to classify their traffic, to adjust and apportion their rates so as to meet the necessities of commerce, and generally to manage their important interests upon the same principles which are regarded as sound, and adopted in other trades and pursuits (p. 232)."

In *Interstate Commerce Commission v. Louisville & Nashville Railroad Company*, 73 Fed. 409, Mr. Justice Clark, writing the opinion of the court, said:

"The Interstate Commerce Act is not to be construed so as to abridge or take away common law rights of the carriers to make contracts and adopt proper business methods further than its terms and recognized purposes require."

See also *Interstate Commerce Commission v. Chicago Great Western Railway*, 209 U. S. 108.

The Act to regulate Commerce, as amended, prohibits excessive and unjustly discriminatory rates and practices, whether accomplished by the payment of rebates or otherwise on the part of interstate railways, and in order to prevent evasions of this law has empowered the Interstate Commerce Commission to prescribe *the form* of all accounts, etc., relating to three specific things, namely, the movement of traffic, the receipt of money, and the expenditure of money.

The regulations in question, however, appear to be devised on the theory that the Commission has been authorized to control the accounts in matters of *substance* as well as in those of *form*, in matters of *estimate* as well as in the *formal record of actual happenings*. Broad as are the administrative powers of the Commission, it is submitted that these regulations transcend the utmost limits of its lawful authority; that it has no more power than a court to "create a rule instead of applying one already made"; and that this is particularly true when the rule attempted to be made would, if effective, restrain "the exercise of that power over property which ownership gives."

While it is believed to be true that all the power delegated to the Commission is contained in the provision authorizing it to prescribe the forms of accounts, it has sometimes been supposed that there was something in the nature of such a grant of power in the following provision of Section 20:

"The said Commission may in its discretion for the purpose of enabling it the better

to carry out the purposes of this Act, prescribe a period of time within which all common carriers, subject to the provisions of this Act, shall have, as near as may be, *a uniform system of accounts* and the *manner* in which such accounts shall be kept."

If the question whether this provision is to be considered as a grant of power is material, it would seem that the answer must be in the negative for the reason that this provision was in force from 1887—the date on which the Act to regulate commerce first took effect—to 1906—the date on which the Hepburn Act took effect—and that if it contained an effective grant of power, the further provision later enacted as a part of the Hepburn Act would have been unnecessary. That Congress saw fit in 1906 to grant the power to prescribe the forms of accounts is perhaps the best evidence that it had not previously done so. Nevertheless, since this clause does not by its terms in any way enlarge the power conveyed by the Hepburn Act, the question thus presented does not seem to be material.

As above stated the provision authorizing the Commission to prescribe "a uniform *system* of accounts and the *manner* in which such accounts shall be kept" was a part of the Act of 1887. At that time Section 20 contained no provision prohibiting the carriers from keeping such other accounts as they might desire. This provision at the time it was enacted related merely to the *uniformity* of the accounts which were prepared for the use of the Commission and the *manner* in which they should be kept. It is significant that the two provisions authorizing the Commission to

prescribe the *form* of the accounts and the provision prohibiting the carriers from keeping any other accounts were *simultaneously introduced into the Hepburn Act*. This provision, inserted in the Statute at such a time, cannot be accounted for in any other way than by the conclusion that Congress intended the word "form" to be a limitation on the power of the Commission in dealing with the only accounts which the carrier is permitted to keep.

These views as to the scope and limits of the authority of the Commission under the Act to Regulate Commerce, are strictly in accord with the opinion of this Court, in the case of *Goodrich Transit Co. v. Interstate Commerce Commission*, 224 U. S. 194, in which Mr. Justice Day, speaking for the Court, said (page 211):

"The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission, is *not to enable it to regulate the affairs of the corporations not within its jurisdiction but to be informed concerning the business methods of the corporations subject to the Act*, that it may properly regulate such matters as are really within its jurisdiction. Furthermore, *the requiring of information concerning a business is not regulation of that business.*"

*The Regulations will curtail and may absolutely prevent the payment of dividends on the Petitioner's preferred stock which is non-cumulative and payable only out of the net current earnings of each year.*

Dividends on the Preferred stock of the Petitioner at the rate of 4% per annum are *non-cumulative* and are payable, under the Petition-

er's charter, only out of the current net earnings of each year (*Testimony*, p. 38). If the sum of \$400,000, is charged to Operating Expenses, the net amount available for dividends will be reduced by that amount.

At pages 13-14, *supra*, we have set forth the figures showing the extent to which the preferred stockholders will be deprived of their dividends.

While the Act goes no further than to authorize the Commission to prescribe the "form" of the Petitioner's accounts—that is, the records of accomplished facts—the regulations in question undertake to control the Petitioner in its relations to its stockholders.

Concerning this proposition the following is quoted from the testimony of Mr. R. J. McCarty (*Testimony*, p. 156):

"Q. Will you explain it? A. For instance, you take it on the Kansas City Southern; the Kansas City Southern pays 4 per cent non-cumulative dividends on its stock. That dividend cannot be declared unless it is earned during some fiscal year. Now, if, according to these regulations, this \$500,000 should be charged to the income account it would cause the company to pass the dividend during that year, and it would be very disastrous to the company, to its credit and stockholders and everybody concerned; whereas, to charge the \$500,000 to Profit and Loss, would simply mean to charge it as against the surplus that had accumulated in previous years over and above what the Company had paid out. That is one of the principal differences."

Thus, under the guise of determining, a question of accounting, the Commission may render impossible the payment of dividends actually

earned and otherwise payable on the Company's preferred stock.

*The lawful determination of the Petitioner to finance this improvement costing \$600,000 out of the proceeds of a bond issue is refuted to the amount of \$400,000 by the Regulation which compels the Petitioner to pay \$400,000 of the expense out of operating revenue and to restore that amount to the bond account and return it to the Trustee of the mortgage.*

The Petitioner had power, in its discretion, to use for this purpose either any moneys on hand derived from earnings or to borrow the amount upon its bonds secured by mortgage. It elected to adopt the latter method of financing the improvements. To that end it executed its mortgage, sold its bonds and has actually expended the proceeds thereof in making the improvements in question.

If this transaction is allowed to remain in this form, it will be represented on the books by an item of \$600,000 under the head of Improvements (a sub-division of the Property Account) and by an item of \$600,000 of outstanding bonds under the head of Liabilities.

At this juncture, however, the Commission requires that \$400,000, which has previously been paid out of the bond account, shall be charged to Operating Expenses. It must therefore be returned to the bond account because, obviously, the books could not truthfully declare that the item came from two different accounts.

But if the \$400,000 is charged to Operating Expenses, the money represented thereby must be



taken from operating revenue and applied toward the improvements. Since the entire expense has previously been paid from the bond account, the \$400,000 received from operating revenue must be returned to the bond account.

The net result of the transaction is that the \$400,000 has been advanced as a temporary loan from the bond account; and is ultimately repaid from operating revenue and must be returned to the Trustee of the mortgage.

There is no escape from this conclusion. It was expressly admitted by Mr. Adams. He testified as follows (*Testimony*, p. 419):

*Re-direct examination by Mr. Needham:*

“Q. If this \$600,000 had been borrowed for the purpose of making improvements, and \$200,000 had been expended for such improvements, and there was \$400,000 net of that cash remaining, that \$400,000 could not be used for dividends, could it, Mr. Adams?  
A. No, sir.

Q. It would be carried on hand and would be reflected in the final statement, but it would be carried as cash that could not be used for the purpose of dividends; is that right? A. That is correct.

Q. Now, suppose the \$600,000 had been expended, and \$200,000 had been charged to the property account and \$400,000 had been charged to operating expenses, that would still leave the same amount—\$400,000—received from current revenues, which would represent the balance of that \$600,000, would it not? A. Yes, sir.

Q. And that \$400,000 would be just as sacred from the payment of dividends as in the former case, which I have given you? A. Yes, sir.

Q. That is correct, is it? A. Yes, sir; that is correct.

Q. Now, when you say that could not be used, you mean it has gone into that account and must be used for improvements? A. I mean—perhaps, to make it clear, I might say that *I mean the same thing which I understand the brief in this case means, when they say that this must be restored to the bond account.*

\* \* \* \* \*

*Re cross examination by Mr. Wickwire:*

Q. Just a question. In case the company complied with the regulations of the commission, there would be \$400,000 which would have to be restored to the bond account, would there not? A. *I think—yes, I think that is a reasonable way to put it. Have it restored to the bond account and then that is merely a recognition of the fact that its destination is to improve the property, so that ultimately for whatever amount of new bonds you issue you have got an increase of your property to that amount, which validates your securities."*

That this is the result of these orders, and that it was intended to be the result, is evident from the following excerpt from a letter written by Prof. Henry C. Adams to Vice-President McCarthy, in relation to the matters involved in the case at bar:

*"In the second place the question of capitalization, by which I mean the amount of securities outstanding against the property is involved; and it has been thought proper by the Commission to adopt those accounting rules which will tend to limit the increase of permanent securities to the increased investment in the property on account of improvements" (Record, page 169).*

It thus appears that although the directors in their discretion have determined to finance these improvements by expending \$600,000 out of the proceeds of the bonds, the Regulation prohibits them from spending more than \$200,000 from the proceeds of the bonds and forces them to expend \$400,000 of the amount out of operating revenue.

## POINT II.

### **Property abandoned as an incident to permanent improvements is not an Operating Expense.**

#### *The Principles of Accounting.*

The double-entry system of bookkeeping has been evolved by experience, and is the most accurate and reliable system of recording financial facts.

By this system every item is entered twice; once on the debit or credit side of one account, and again on the counter balancing side of another account.

There are two sets of accounts, namely, (a) the Property Accounts, and (b) the Operating Accounts.

The Property or capital accounts represent the investment of the stockholders, and show the cost of the property originally acquired by the corporation; to which is added from time to time the cost of additional property and improvements to the property.

Opposite the assets are placed the "Liabilities" under which are entered the amount of the capital stock, the bonded indebtedness and any other indebtedness. If the corporation has on hand any profits or surplus, the amount thereof is also entered on this side of the balance sheet under the head of "Profit and Loss", which represents a liability of the carrier to its stockholders. The total of all the liabilities is exactly equal to the total of all the items in the property account, or "assets."

In the Operating Accounts are entered on one side the company's receipts or gross earnings for the year; and on the other side the total expenditures involved in producing gross earnings and in maintaining the property; the balance being the net earnings.

The Income Account is for the purpose of showing the net results produced during any given fiscal year. On one side is shown the total gross earnings from operations and also revenues from any other sources. On the other side is shown the operating expenses, or the expenses actually incurred in producing gross earnings. On this same side are also shown taxes, interest on its bonds and other appropriate charges. The balance of this Income Account represents the net income of a carrier from all sources during the year, the total of which balance is then carried to the Profit and Loss Account.

The Profit and Loss Account is for the purpose of showing the net accumulated surplus of the carrier, which net accumulated surplus is shown by the balance of this account.

The operating accounts, covering the current activities of the company, are kept for the pur-

pose of showing *the results of the current business*. They record the receipts and the disbursements incident to earning revenue and maintaining the property in repair; and the resultant balance represents accurately the results of the year's operations. The carrier's prosperity and credit depend upon the results shown by these accounts. By comparison with the accounts for prior years, one may see at a glance the relative results of the company's operations. If the net earnings have decreased, the corporation has had a less prosperous year; if the net earnings have increased, the increase measures the company's improvement in its business.

Where a corporation, for the purpose of making additions or betterments to its roadway or equipment, issues bonds and uses the proceeds thereof for such purpose, the transaction is reflected by two entries, one on each side of the general balance sheet. One entry under "Liabilities" shows the increase in the bonded indebtedness; and the other for the same amount under the head of "Assets" shows the cost of the additions and betterments. *Neither of these items or any other item goes in any way into the operating accounts, which, as stated above, are wholly distinct and kept for a distinct purpose.*

The Interstate Commerce Commission's Fourth Annual Report on the Statistics of Railways in the United States (*p. 73*) states:

"The science of accounting contains two statements designed to throw light upon the general condition of the business to which they pertain. These are the income account or a statement of earnings and expenses incident to the transaction of a business during the period (usually one year) for which it

is drawn, and the balance sheet which places assets against liabilities in such a manner as to show the financial standing of the company. The former account indicates the degree of success which has attended the year's operations; the latter sums up the financial operations of the corporation from the beginning of its life to the period of report."

Every one interested in ascertaining the result of the corporation's business examines its operating accounts for that purpose. The absolute accuracy of these accounts, therefore, is of the highest importance to the stockholders, the bondholders and the public, whose investments in large degree are influenced by inferences drawn from examination of the operating accounts and a comparison thereof with the accounts of prior years.

*The Petitioner contends that since the original locations were necessary in the development of the line, and were abandoned only as an incident to the improvement and development of the property, the cost thereof, being a part of "the cost of progress," should remain in the property account as a part of the stockholders' investment.*

A careful definition and analysis of operating expenses, as distinguished from capital expenditures, are necessary to the determination of these questions.

In *Union Pacific R. R. Co. v. United States*, 99 U. S. 502 (decided in 1878), the act of Congress to aid in the construction of the railroad, approved July, 1863 (12 Stat. 489), provided that government bonds should be issued to the railroad company to assist in the construction of the

road and that after the road was completed and until the bonds and interest were paid, "at least five per centum of the net earnings of such road shall be annually applied to the payment thereof." It was held that within the meaning of the law "net earnings" were to be ascertained by deducting from the gross earnings all the ordinary expenses of organization and of operating the road and expenditures made *bona fide* in improvements and paid out of earnings and not by the issue of bonds or stock.

Mr. Justice BRADLEY, delivering the opinion of the court, said:

"The question next arising is, What are the 'net earnings' for five per cent. of which the company became liable to account, and in what manner are they payable?

"In the first place, they are the 'net earnings of the road'; that is, the net earnings of the road as a railroad, including the telegraph. They have nothing to do with the income or profits of the company as a holder of public lands. The proceeds of this source of income are no part of the earnings of the road. These earnings, however, must be regarded as embracing all the earnings and income derived by the company from the railroad proper, and all the appendages and appurtenances thereof, including its ferry and bridge at Omaha, its cars, and all its property and apparatus legitimately connected with its railroad. (*pp. 418-419*) \* \* \*

"Having considered the question of receipts or earnings, the next thing in order is the expenditures which are properly chargeable against the gross earning in order to arrive at the 'net earnings,' as this expression is to be understood within the meaning of the act. As a general proposition, *net earnings are the excess of the gross earnings*

*over the expenditures defrayed in producing them, aside from, and exclusive of, the expenditure of capital laid out in constructing and equipping the works themselves. It may often be difficult to draw a precise line between expenditures for construction, and the ordinary expenses incident to operating and maintaining the road and works of a railroad company. Theoretically, the expenses chargeable to earnings include the general expenses of keeping up the organization of the company, and all expenses incurred in operating the works and keeping them in good condition and repair; whilst expenses chargeable to capital include those which are incurred in the original construction of the works, and in the subsequent enlargement and improvement thereof."*

That expenditures for Additions and Betterments are not and cannot be classified as "Operating Expenses" was clearly announced by the Interstate Commerce Commission in the case of *Illinois Central Railroad Co. vs. Interstate Commerce Commission*, 206 U. S., 111, and this declaration was distinctly affirmed by the Supreme Court. The Commission held that repairs were properly chargeable to "Operating Expenses," but that expenditures for improvements and equipment should not "*be taxed as part of the current or operating expenses of a single year, but should be, so far as practicable, and so far as the rates exacted from the public are concerned, projected proportionately over the future*" (page 119).

Mr. Justice McKenna, delivering the opinion of the Court, said:

"The findings show that the old rates were profitable and that dividends were declared



even when permanent improvements and equipment were charged to operating expenses. But may they be so charged? Appellants contend that the answer should be so obviously in the affirmative that it should be made an axiom in transportation. *On principle it would seem as if the answer should be otherwise.* It would seem as if expenditures for additions to construction and equipment, as expenditures for original construction and equipment, should be reimbursed by all of the traffic they accommodate during the period of their duration, and that improvements that will last many years should not be charged wholly against the revenue of a single year."

It is true that in the Union Pacific case the Court, while distinctly setting forth the true definition of "Operating Expenses," gave those words as used in the statute then under consideration a somewhat enlarged meaning, but this was done in view of what the Court found to be the purpose of the Act. In the later case of *Illinois Central R. R. Co. v. Interstate Commerce Commission* (*supra*) the Court refused to follow the broad and unusual interpretation applied in the Union Pacific case and declared that permanent improvements should not be charged to operating expenses. Mr. Justice McKenna said:

"But it is insisted that Union Pacific Railway Co. *vs.* United States, 99 U. S., 402, establishes the contrary. That case was not concerned with rates of transportation or the rule which should determine them against shippers. It was concerned with the construction of the words 'net earnings' in an act of Congress, five per cent of which earnings were provided to be applied annually to a loan by

the Government to the railroad. Considering the provision of the act and its purpose, it was concluded 'that the true interest of the Government' was 'the same as that of stockholders, and would be subserved by encouraging a liberal application of the earnings to the improvement of the works.' '' (pp. 461, 462).

After quoting from the decision in the Union Pacific case, Mr. Justice McKenna continued:

"The interest of the Government in the improvement of the road was even greater than that of a stockholder. This was manifest from its munificent gift of lands, in addition to its generous loan of credit. As benefactor of the road and as creditor of it, as a Government concerned with the development of the country, as a money lender concerned with the extent of security, 'the true interest' of the United States might be that revenue should be applied to improvements. Payment of the debt was only postponed, not denied, and this and the other considerations, might well determine the construction of words in the statute which were capable of different meanings. But such is not the relation or concern of a shipper of lumber. His right is immediate. He may demand a service. He must pay a toll, but a toll measured by the reasonable value of the service. The elements of that value may be many and complex, not always determinable, as we have seen, with mathematical accuracy, but, we think, it is clear, *that instrumentalities which are to be used for years should not be paid for by the revenues of a day or year; and this is the principle of returns upon capital which exists in durable shape*" (p. 463).

The exact nature and limitations of the phrase "Operating Expenses" have been recognized in

many decisions of the Court. (See Lackawanna Coal & Iron Co. *vs.* Farmers Loan & Trust Co., 176 U. S., 298; Wood *vs.* Guarantee Company, 128 U. S., 416; Fordyce *vs.* Omaha, Kansas City & E. R. R., 145 Fed., 544; Illinois Trust & Savings Bank *vs.* Doud, 105 Fed., 123, citing many cases).

Attention is asked to the following extracts from the annual reports prepared by the Statistician of the Interstate Commerce Commission, and published by its sanction and with its authority.

"It is the purpose of the summary next submitted to analyze expenditures. They are divided first, into operating expenses and fixed charges. Under operating expenses are included expenditures chargeable to maintenance of way and structures, maintenance of equipment, conducting transportation, and general expenses." *Eighteenth Annual Report on the Statistics of Railways in the United States*, p. 84.

"Provision has been made for an authoritative Classification of Additions and Betterments. The promulgation of an order covering this class of expenditures is imperative as a means of guarding against the overstatement of operating expenses by carriers during exceptionally prosperous years. This does not mean that stockholders are denied the liberty of improving their property out of the current revenues. That is a matter of policy and not of accounting. *It does mean, however, that in case stockholders approve the policy of improving property out of current revenues, the expenditures on account of such improvements should be charged in the Income Account, and not included in an account the chief purpose of which is to measure cost.*" *Nineteenth Annual Report on the Statistics of Railways in the United States*, pp. 11, 12.

The foregoing extracts show that the Commission has insistently demanded the rigorous restriction of the operating expense accounts to items of expense incurred directly in producing the transportation services and the total exclusion therefrom of items of expenditure incurred in the improvement of the facilities provided by capital expenditures. It is strangely inconsistent with this record that the Commission should now be found insisting that a large share of the cost of improving the Petitioner's facilities should be charged to operating expenses.

For the purpose of determining the precise scope of the term "Operating Expenses" considerable testimony was received by the court below. It would seem, however, that the meaning of a statutory term should not thus be made the subject of evidence. It must be clear that the meaning of the phrase "Operating Expenses," as used in the Statute presents a question of law to be determined by the Court upon principles of law, and that it is not a question of fact to be decided upon conflicting evidence. If the rule were otherwise different Courts at different times might reach contrary conclusions upon the interpretation of the same statute depending upon which witness was believed. Mr. Noy, Comptroller of the Chicago, Rock Island & Pacific Railroad (*Testimony*, p. 70), Mr. L. A. Jones, Vice-President and Comptroller of the New Orleans & Northwestern Railroad (*Testimony*, p. 83), Mr. S. M. Hudson, Auditor of Fort Worth & Denver City Railway (*Testimony*, p. 95), Mr. A. H. Plant, Comptroller of the Southern Railway (*Testimony*, p. 130), Mr. McCarty, Vice-Presi-

dent and Auditor of the Petitioner (*Testimony*, p. 153), Mr. W. H. Williams, Vice President of the Delaware & Hudson (*Testimony*, p. 177), Mr. Seger, Deputy Comptroller of the Union Pacific (*Testimony*, p. 206), Mr. Scott, Auditor of the Minneapolis and St. Louis (*Testimony*, p. 222) each testified to their opinion that charges to the operating expense account of property abandoned in connection with improvement through grade reduction, could not be justified. Mr. Adams, Mr. Farrington, Mr. Bailey and Mr. Lutz, testified to the contrary, but based their opinions on the theory that the abandonment of these sections of line was made necessary by their inadequacy to handle the increased traffic and that inadequacy was a form of depreciation. This theory is without foundation as we shall demonstrate *infra*, pp. 53-55.

Even Mr. Henry C. Adams, in charge of Statistics and Accounts of the Interstate Commerce Commission at the time the regulations were promulgated, admitted, on cross examination, that the charge, if made to operating expenses, would be fictitious. A hypothetical case was propounded to him in which it was assumed that for the purpose of reducing grades original track costing \$400,000 had been replaced by new track of lower grade on different ground, and that under the regulations of the Interstate Commerce Commission this amount of \$400,000 had been charged to Operating Expenses, though the improvement had been paid for out of the proceeds of a bond issue. He testified as follows:

“Q. Yes, the operating account. Is that a correct statement of the operating account as it will finally stand? (Handing paper to

witness). A. In this operating expense, you have got your Four Hundred Thousand dollars.

Q. Yes. A. That is true. That means that you have collected of revenues \$400,000, more than your income than your revenue statement calls your earnings for that year.

Q. How is that? A. I say that means that you have included in operating expenses *a charge that does not mean an expense*" (*Testimony*, p. 401).

Thus was Mr. Adams forced to admit that the regulations require to be charged to operating expenses an item that is not an expense.

It clearly appears, therefore, that the Interstate Commerce Commission requires the Petitioner to charge to operating expenses an item which is not an expense and which item represents an investment in productive property abandoned in the course of improvements made necessary by an increase of traffic.

*The original investment was necessary in order that the second investment might be made.*

Railroads in a new country, considered in the light of the subsequent development of the country, are in the nature of temporary structures, to be improved or enlarged as increasing needs demand.

Mr. Loree testified (*Testimony*, pp. 47-48):

Q. Taking into account the circumstances of this particular case, Mr. Loree, will you say whether or not this road as originally constructed, in the country through which it then went, and constructed on an average one per cent grade, was or was not merely a stage in the progress of the construction of a road

that would eventually, when the country grew up, have to have a five tenths per cent grade?

A. I think so, yes, sir. That is the history of nearly all the roads in the United States. They all had to be changed in their character.

Q. As their needs increased and their traffic increased? A. Yes, sir.

Q. And in a new, sparsely settled territory, such as this was when the road was constructed, could it have supported a line built as expensively as a five tenths per cent grade would require to be built? A. I think not, and I do not think the money could have been raised to do it.

Q. You could not have gotten the capital for it? A. No.

Q. It is the invariable history of railroad construction, is it not, that the lines have to be improved as business increases? A. That has been the history of the country, yes, sir.

Q. When you are building a line through a new country, you cannot get the money to build it as it eventually must be built when the country is built up. A. That is true.

Q. What should you say, then, as to the original road in respect to its being in the nature of a temporary structure? A. I should say it had that element in it, yes, sir.

Q. And that is an element incident to all railroad construction? A. I think so, yes, sir."

The evidence is clear and uncontradicted that the original road constructed at a ruling grade of one per cent has produced the necessity for the new line having a ruling grade of one half of one per cent. The sections of roadbed which were abandoned were a step in the development of the final road. Under these circumstances it is evident that the sections of the old road to be abandoned should not be treated as

property destroyed but that they should be retained in the property account, since they were the means which made possible the improvement of the property as it will exist after the grade revision is made. Any other rule would ignore what has been accurately called the "cost of progress" an element invariably present in every enterprise. No successful business has ever escaped this penalty. No brief in complete form has ever been submitted to a court that did not in the preparation send more paper to the wastebasket than to the printer. The mere cost of the reproduction of the article in its finished condition is not the correct test, for the waste is there and must be reckoned with. The case in this aspect is analogous to that of the scaffolding used in the erection of a house. The scaffolding is discarded after the house is complete, but it is beyond all question a proper addition to the cost of the house because it was necessary in order to produce the house. The same argument applies with great precision to the case at bar. Except for the old line the new line could never have come into existence, for the old line produced the necessity for the new. One of the elements in the cost of the new sections of line is the construction of the old sections, which alone made possible the construction of the new. To quote again the language of the Interstate Commerce Commission on the subject:

"The first investment was necessary in order that the second investment might be made" (*Twentieth Annual Report of the Interstate Commerce Commission 1907*; p. 21.)

Depreciation is not an expenditure of money. The reason for charging depreciation to operat-



ing expenses is because it is uneconomical to repair certain forms of wear and tear at the time it takes place; and therefore an amount estimated to represent this wear and tear is set aside in the depreciation account in order that there may be charged against the revenues of each year its fair proportion of repairs necessary to maintain the efficiency of the plant up to its original standard.

But this does not justify a charge to operating expenses of the cost of permanent improvement; and included in that cost is the value of property discarded in the course of improvement. This is not a legitimate "maintenance charge." *It is not a necessary expenditure in order to maintain the company's property up to its standard.* It is therefore not an operating expense.

Mr. Frank Nay, Comptroller of the Chicago, Rock Island & Pacific Railroad testified:

"My reasons are that the cost of such improvements— and I refer to where a line is built across a slightly different part of the country, perhaps a mile or two away from the old line and in place of the old line—that the cost of such construction of the new line is an additional investment of capital and as such should always be represented in the capital account; that a railroad is never completed. In the first place, surveys are made three or four or five or six and sometimes a dozen in number, and but one of them is adopted. The others might be said to be abandoned, but they were necessary steps in the progress of locating the line. The line is built for the conditions of traffic at the time of construction. Later it is necessary to improve it in various ways, and it may be built with one or one and a half per cent. grade in the beginning. As the traffic grows

it is necessary to reduce that grade for economy and efficiency in service. The reduction may be by cutting down high places in the road and filling in low places on the same right of way, or it may be by locating a line over a short distance from the old line. In either event, the ultimate purpose and result is the same, and the expenditures in either event represent additional investments of capital and should remain in the capital account as showing the investment made by the company" (*Testimony*, p. 70).

Mr. L. A. Jones, Vice-President and Comptroller of the New Orleans & Northeastern Railroad, the Alabama & Vicksburg, and the Vicksburg, Shreveport & Pacific Railway, testified:

"As I consider it, the cost of the original property was properly shown as cost of property, and the existence of that original property rendered it possible, by its credit and by its good will, to improve the property through additional securities, and therefore it is a step in the completed property just as much, even though the property be not actually used physically by the trains, as though it were used. It is an essential step in the building up of the present property.

"Q. In other words, you could not have started with a property of the character of the present property? The country could not have afforded it? A. I know of no railroad that was built to what may be termed the highest standard of efficiency at first. It is built at a standard which is warranted by the conditions of the country and the traffic afforded at that time, and as the development of the country warrants, the financial condition of the company permits, and the needs of the traffic require, the property is developed and improved in its standard" (*Testimony*, p. 81).

Mr. Charles B. Seger, Deputy Comptroller of the Union Pacific, testified:

"My judgment in that matter is based on what I would be pleased to term the principle that, in the creation and operation of a transportation system of railways, there are two distinct propositions involved. One is the creation of the plant with which to do business. The other is the maintenance and the operation of a plant after it has been created, whether as an original proposition or during the life of the plant. There I draw the distinction. Everything, no matter when or how spent or how the money is obtained, which contributes to the creation of the property, is in my judgment a proper charge to the cost of the property, and, as distinguished from that, all moneys expended in the maintenance of the property in its original state and the operation of it are a proper charge to operating expenses, and no more in my judgment is a proper charge to operating expenses. Following that principle, I reached the conclusion that the change in the location of these portions of line was in the nature of the creation of property or the betterment of the original property, and therefore in no wise chargeable against the operations of the road" (*Testimony*, p. 206).

*All this evidence is undisputed.*

Even Mr. Adams' admitted that the stockholders should not lose their investment, under the circumstances of this case. He testified (*Testimony*, p. 382):

"Q. Did not the stockholders in the beginning pay for this abandoned property?— A. They did.

"Q. And you have said that they should not lose it upon abandonment?— A. Yes.

"Q. They should not lose their investment?

A. Yes, sir.

"Q. And if they are allowed to have it stand in the property account as an item, then they simply receive payment for it in the future in the same way as they would for property which is not lost?— A. Yes. That controls the other side of the question, which is the public side of the question, and the question involved in reasonable rates—that is in that case, you have actually thrown away property, but you retain in your property record a certain amount of money. Now, the courts require, as I understand it, that a reasonable rate is the rate upon the property used in rendering the service of transportation. Therefore, in the application of those rules you make good the rate upon a portion, even though you call it investment; you can not get the rate upon the property unless it is used, and this abandoned property is no longer used.

"Q. Then the only way the stockholder can get paid for abandoned property, according to your theory, is by imposing the cost upon operating expenses?— A. That, I think is true.

"Q. And if, by reason of competitive conditions, he is unable to secure, through his rates, anything more than merely a fair return upon the balance of his property not abandoned, then he loses the cost of the abandoned property, does he not?— A. Yes, sir; if the directors put up such a policy of improvement."

The cost of a railroad, particularly in a new country, is not only the cost of the property actually in use; it is the full cost of creating the utility in its existing condition. It is undisputed that the original locations now to be abandoned

were not unwisely made. It is undisputed that the road as it will exist after the grade revision is complete could not have been developed in any other way. The old sections are not abandoned because they are not in repair; they are abandoned because they have fulfilled the very purpose for which they were constructed, *i. e.* the development of sufficient traffic to justify the construction of the new sections.

*The theory of depreciation advanced in support of the Regulations has no application to the facts of this case.*

Mr. Adams sought to avoid the logical effect of the foregoing considerations by extending the doctrine of depreciation far enough to embrace this case.

The Commission's argument assumes that the property in question depreciated by the amount of \$400,000 not because it was not in first class condition but because of an increase in the traffic of the road. This is shown by the testimony of Mr. Farrington, a witness for the Respondents (*Testimony, pp. 292-3*):

"Q. Would you include in depreciation losses caused by inadequacy of the line or inadequacy of the equipment to carry the traffic to meet the demand upon it? A. I should cover that by depreciation, yes."

The theory of the Commission as disclosed by this and other testimony is that an increase in the volume of traffic rendered the abandoned property inadequate, and since the abandoned property was inadequate, it is assumed to have depreciated (notwithstanding the fact that the

abandoned property was in perfect condition at the time of its abandonment) and because of this assumed depreciation the amount thereof should be charged to the current Operating Expense of the Petitioner.

Inadequacy may arise from depreciation in the case of property that has not been maintained in proper repair, but depreciation does not necessarily follow from inadequacy, and certainly does not follow where the inadequacy is caused by an increase of traffic which the original property is no longer able to handle with efficiency.

The railroad has not changed. No obsolescence has taken place by reason of any development in the art of railroading. The only change has been *in the development of the tributary country and in the corresponding increase in the volume of traffic offered to the road.*

If the Petitioner had not undertaken the reconstruction of its line the claim could never have been made that any depreciation had taken place, and the road would have remained in its former condition, fully able to earn as much as before. But because the Petitioner has developed sufficient traffic to justify extensive improvements in order to increase its efficiency, (thereby incidentally necessitating the abandonment of certain sections of line), it is argued that depreciation has been taking place throughout all these years, although *it is admitted that if the traffic had not increased sufficiently to justify the reconstruction of the road, there would have been no depreciation.*

This analysis of the situation shows that, in fact, there had been no depreciation, but on the contrary, an actual appreciation in the property,

brought about by an increase in traffic. There is therefore no justification for the application of any rule or theory of depreciation.

We believe that we have clearly demonstrated that, even if the Commission had power to control the internal management of carriers by determining whether the items in question should or should not be charged to operating expenses, the Commission has wrongfully exercised that power to the substantial injury of the Petitioner and its preferred stockholders. But, irrespective of this question, we confidently submit, as contended in our first point, that the Commission was wholly without power to make the regulation because prior to the regulation and from time immemorial this was a matter wholly within the discretion of the directors. Some railroads, as the evidence shows, had for many years been accustomed to charge these items to operating expenses; while other railroads, and a much larger number, had followed a contrary practice. The matter had always been a subject for determination, not by the accountants of the railway companies as a matter of accounting, but by the board of directors *as a matter of policy*. It is therefore evident that the Commission was without power to make this regulation because it extends far beyond the domain of form and interferes with business otherwise exclusively within the control of the carrier.

The Commerce Court should therefore have set aside the order complained of because it "was based upon the assumption by the Commission of the possession of power not conferred by law" and "the mere form given by the Commission to its action does not relieve the courts from the

### POINT III.

**Even the theory on which the respondents attempt to support the regulations does not, when analyzed, justify a charge to Operating Expenses, but at most a charge to Profit and Loss.**

Mr. Adams' theory is that, according to the ideal method of meeting the depreciation (which he erroneously assumes has taken place) a reserve should have been set up during prior years through charges to operating expenses, and such reserve should now be applied to meet the alleged depreciation. If this had been done the charge would of course be made to this fund, and no charge would now be made to operating expenses.

But the Petitioner's surplus (profit and loss) account is a reserve which is applicable to all appropriate contingencies, including that arising from depreciation (if this were a case of depreciation). Where property is abandoned and *not replaced*, the amount of it is charged, under the principles of accounting and according to the regulations of the Commission, to *profit and loss*. If a portion of the Petitioner's surplus, when it was set aside, had been labelled "Reserve to care for replaced or abandoned property", then, accord-



ing to the Commission's regulations, it would have been proper to have charged the \$400,000. to this reserve; and had this been done *the net result would have been exactly the same as if the \$400,000. were to-day charged to profit and loss.* In other words, an accumulated surplus is essentially a reserve set aside to meet contingent losses; and if this case involves depreciation the charge should be made to the profit and loss account and *not to current operating expenses.*

#### POINT IV.

Since the Act to Regulate Commerce penalizes the keeping of any other accounts, records or memoranda than those prescribed by the Commission, and since the Act requires that the annual reports shall "show in detail" (1) "the cost and value of the carrier's property", (2) "the amounts expended for improvements each year", (3) "the operating and other expenses", and (4) "the balance of profit and loss", the Commission cannot promulgate rules which would leave the carrier without a true record of the facts to be included in the annual reports.

The proposition now under consideration is that the authority to prescribe the "form", restricted

as it is by the meaning of that word, is also to be regarded as limited by the general purposes of the Act to Regulate Commerce, and more particularly, by the general purposes of Section 20. The cardinal purpose of Section 20 is obviously, and according to the construction put upon it by this Court, to enable the Commission to obtain from the carriers annual reports which shall assist the Commission to obtain the information necessary to enforce the principal requirements of the Act, *i. e.*, that rates and regulations shall be reasonable and that there shall be no unjust discrimination between shippers, communities or kinds of traffic.

Section 20 as originally enacted provided for such annual reports, indicated with precision the items which they should cover and was doubtless believed at the time to be sufficient for those purposes. Difficulties, however, developed. The Commission complained that the methods of recording facts relating to the movement of traffic, and the receipts and expenditures of money, were not uniform; that it was without authority to inspect the books of the carriers regarding these facts, and that these considerations seriously impaired the value of the annual reports and the accuracy of the compilations made from them. To remedy these defects, Section 20 was revised by the Hepburn Act, but without materially changing the original Section, and substantial additions were made thereto including the grant of authority to prescribe the forms of accounts, the right of access to the accounts, and provisions for the employment of examiners of accounts who might act in behalf of the Commission.

From the beginning, however, and through all its revisions, Section 20 has preserved the original requirements that the annual reports which all common carriers must render *must show*, among other matters, the following:

1. The cost and value of the carrier's property, franchises and equipment,
2. The amounts expended for improvements each year, and how expended,
3. The operating expenses,
4. The balance of profit and loss.

In view of the history of the Section it is necessary to regard all the amendments as intended to be in harmony with the requirements concerning the annual reports and as intended to strengthen the machinery for procuring such reports and to enhance their accuracy and reliability. If, however, the Petitioner having expended \$600,000, secured by the sale of bonds for improvements, can be compelled to charge \$400,000 of that amount to the Operating Expenses of one year, or to distribute that amount among the Operating Expenses of a series of years and if it is forbidden to keep any other record representing the transaction, it will have in its possession no account or record from which it can report accurately either the cost of its property or the cost of improvements, or its operating expenses. Even granting the contention of the Commission that there was an impairment of the value of the property in the full amount of the replacement cost of the abandoned sections, and that this impairment is a deduction in the balance sheet from the amount representing the property, the fact

remains that the Petitioner made an improvement which cost \$600,000, which required an addition of that amount to its bonded indebtedness and that it did not expend in the year in which the abandonment occurred or in any series of years for operating expenses any amount representing the replacement cost of the property.

Moreover, the meaning of the term, "Operating Expenses" was definite at the time the Act to Regulate Commerce was originally passed, and as it is a part of the language of the grant of power, it is not a term which the Commission is authorized by the Act to define, much less one which it can enlarge by construction. From April 4, 1887—when the work of the Commission began—to January 21, 1909—when the first of the orders complained of was entered—the Commission made no effort to construe or to enlarge this term so as to include any amounts or estimates representing charges on account of the abandonment of property. During this entire period its requirements as to the annual reports directed in Section 20 to be made by carriers, covered, under the head of Operating Expenses, only actual expenditures for the conduct of the business of the carriers, and under Maintenance Charges referred to nothing except actual expenditures for repairs and renewals.

At *pages 361-2* of the record, it appears that Mr. Adams, who throughout that entire period had charge, as an officer of the Commission, of the preparation of the forms of the annual reports and of the compilations of statistics therefrom testified that from the beginning of the work of the Commission until 1906 the term "operating expenses" had never included any charge for

property abandoned in the course of improvements and that no attempt to do so had ever been made by the Commission in any of its previous classifications.

After this interpretation of the meaning of the term "Operating Expenses" had been enforced from 1887 to 1906 by the Interstate Commerce Commission, *Congress re-enacted the precise language of Section 20, under which the Commission had acted throughout all this time.* Hence there is invoked the well-recognized rule that the re-enactment of language which has long been subject to administrative interpretation, such interpretation not being manifestly contrary to the language itself, is an enactment of the administrative interpretation.

*Pennoyer v. Conoughby*, 140 U. S. 1;

*United States v. Folk*, 204 U. S. 143;

*New York, New Haven and Hartford v. Interstate Commerce Commission*, 200 U. S. 361.

We have already shown that the term "operating expenses" had a well-understood meaning at the time this statute was enacted. Congress knew the meaning of the term and did not intend that the operating accounts should include items which beyond all question are not operating expenses. The requirement that the annual reports shall show the operating expenses is an express limitation upon the grant of power to prescribe the forms of the accounts and hence the meaning of the term "operating expenses" cannot be given a false definition by the Commission. (*United States v. Verdi Copper Co.*, 196 U. S. 207).

Moreover, the requirements that the annual reports shall show *the cost and value of the property and the cost of improvements* are equally, and for the same reasons, a substantial qualification of the grant of power to prescribe the forms of accounts. The forms prescribed, to be lawful, must disclose, as far as may be, the facts regarding *cost and value*. But cost is sacrifice, in money or valuable property, and if an improvement has required the sacrifice of actual property as well as the expenditure of money, the real cost of the whole property is not disclosed if the sum added to the original cost is anything less than the money expended. To diminish the sum to be added by a deduction of the estimated replacement value of property necessarily abandoned to produce the improvement is to exclude a substantial portion of the real cost.

The value of railroad property is the value of its use. As the utility increases the value increases. No property is created by man. All property exists in some form or other and all that man does is to adapt it—to change the relation of one piece of property to another. When this changed relation increases the utility it increases the value.

The Petitioner in changing its line at the six points in question merely adapted or changed the relation of those portions of road to the remainder of the road so that when the whole plan of improvements was completed, one locomotive would be able to haul double the tonnage which it was able to haul before. This change in the relation of property enhanced the value of the railroad of the Kansas City Southern Railway Com-

pany, considered in its entirety, by an amount not less than the total amount of money expended in making the change.

## **POINT V.**

**If under any circumstances Congress had power to determine that accounts should be so kept as to include in operating expenses an item which is not an operating expense, and to interfere with the internal management of common carriers, and to deprive stockholders of their dividends, the determination of such a public policy involves the exercise of discretionary legislative functions incapable of delegation to the Interstate Commerce Commission.**

Whether the recognized principles of true accounting shall be applied by common carriers or shall be rejected; whether the cost of new property (such as additions and betterments) shall be subjected to a process of governmental alchemy and transmuted into operating expenses; whether the government shall project its powers into those internal affairs of corporations which have heretofore been exclusively regulated by the States creating them; whether the right of corporations to pay dividends shall depend, not upon whether or not they are earned, but upon the fiat

of the Interstate Commerce Commission—are matters of far-reaching import moving in an orbit that circumscribes and vitally affects the entire nation. It were vain to contend for a moment that these are not matters of public policy, the determination of which is reposed by the fundamental law in the legislative department of our government. The high prerogative of dealing with these questions has not been and cannot be delegated to the Interstate Commerce Commission.

### POINT VI.

**Since the regulations in question compel the Petitioner to make false entries in its accounts and thereby deprive the preferred stockholders of dividends to which they are lawfully entitled, the regulations are in violation of the Fifth Amendment to the Constitution of the United States.**

Whatever may be the power of Congress, by virtue of its authority over interstate commerce, to regulate certain of the activities of corporations organized under State Laws, it is obvious that such regulations cannot destroy vested rights and deprive citizens of property without due process of law.

Railroad corporations are "persons" within the meaning of the constitutional provision which



prohibit the deprivation of property without due process of law.

*Smyth v. Ames*, 169 U. S. 466;

*Charlotte, C. & A. R. R. Co. v. Gibbs*, 142 U. S. 386;

*Railroad Tar Cases*, 13 Fed. 722; 116 U. S. 138;

*Santa Clara County v. Southern Pac. R. Co.*  
18 Fed. 385; judgment affirmed 118 U. S. 394.

In *Wisconsin, Minnesota & Pacific Railroad v. Jacobson*, 179 U. S. 287, the court speaking by Mr. Justice Peckham, said:

"Railroads have from the very outset been regarded as public highways, and the right and the duty of the government to regulate in a reasonable and proper manner the conduct and business of railroad corporations have been founded upon that fact. Constituting public highways of a most important character, the function of proper regulation by the government springs from the fact that in relation to all highways the duty of regulation is governmental in its nature (p. 296). \* \* \*

"While this power of regulation exists, it is also to be remembered that the legislature cannot under the guise of regulation interfere with the proper conduct of the business of the railroad corporation in matters which do not fairly belong to the domain of reasonable regulation."

It has already been shown that the regulations in question require carriers to make false and erroneous entries in their accounts; and the Act to Regulate Commerce requires that the officers of the carriers must keep all accounts in the manner

prescribed by the Commission, and furthermore that they may keep no other accounts.

It has also been demonstrated that the effect of the regulations, if complied with, is to deprive the preferred stockholders of about one-half of the *non-cumulative* dividend to which they are entitled from the net earnings of the Company.

The two chief witnesses who testified in support of the regulations were forced to admit that as a necessary corollary to the proposition by which they sought to justify the regulations, the right of a corporation engaged in interstate commerce to pay dividends depended, not upon the question of whether they were earned or not, but upon the fiat of the Interstate Commerce Commission.

The rule of the Commission that the sum, approximately \$400,000, representing the cost of the property replaced as an incident to the improvement, shall be charged to operating expenses, is modified by a proviso that the Commission may in its discretion, upon application by the carrier, if it appears that the charges if made in one year will unduly "burden" the accounts, permit the charge to be spread over a term of years. (*Petition, fol. 38.*) It is obvious that the framer of the regulations perceived the great injustice to which they might lead and that an effort was made through this proviso to palliate the disastrous results by diluting the evil and spreading it over a term of years.

Mr. Lutz, the first witness in support of the regulations, testified that if a railroad company having no accumulated surplus, should have net earnings on its operations of \$1,000,000 and if in connection with improvement work property of

the estimated value of \$1,000,000 were abandoned, this item of \$1,000,000 would be charged to operating expenses and would entirely wipe out what would otherwise be the net earnings, and that in such case no dividend whatever could be paid. He further testified that if the carrier applied to the Commission and obtained leave to spread this charge of \$1,000,000 over a period of ten years in equal annual installments of \$100,000 each, then the corporation would have left the sum of \$900,000 which it could lawfully distribute in dividends (*Testimony*, pp. 338-339.)

Mr. Adams testified to the same effect. (*Testimony*, p. 304.)

The testimony is undisputed, as previously pointed out, that the regulation requires such a charge to be made to the operating expenses as would have reduced the net income of the Petitioner to a point where only about half the preferred dividend could have been paid, though fully earned.

Thus by a regulation which merely purports to affect the "form of the accounts", the preferred stockholders have been deprived of dividends which the Company has earned and which it desires to pay. The argument advanced by the Commission and by the court below, that such a regulation because ostensibly directed to the form of the accounts does not affect a substantial right and one which is protected from invasion by the Constitution, should not for an instant be entertained. *The result* of the regulation, whatever *its form*, is to deprive the Petitioner's stockholders of dividends legitimately payable, and the rule is elementary that the substance and not the shadow determines the validity of the exercise of

power. By the simple expedient of prescribing the form of the account *and by prohibiting the keeping of any other accounts*, the preferred stockholders are deprived of their property as completely and as effectively as by legislative fiat, and since their dividends are non-cumulative there is no way by which they can recoup their loss.

## POINT VII.

### The Opinion of the Commerce Court.

The opinion of the Commerce Court makes no reference whatever to the Petitioner's argument that the regulation interferes with the Petitioner's *right to manage its own business* by means of the agency provided for that purpose—its Board of Directors.

The opinion proceeds upon the narrow theory that there has been no interference with any tangible property—that the Petitioner has the same amount of property *on hand* as before—and that therefore it has not been injured. The Court fails entirely to consider our contention that an interference with the right to manage property is, in effect, the taking of property.

The rights of the preferred stockholders are considered and disposed of in the fraction of a sentence:

“—and if the effect of the entry will be to reduce the net revenue from which dividends are to be paid, still the preferred stockholders cannot complain as, *the reduction being*

*lawful, they receive as much as they are lawfully entitled to receive."*

This argument begins and ends within a circle. In determining whether or not the reduction of the fund from which dividends are payable was lawful, the Court begins with the assumption that the reduction was lawful; and concludes that therefore the preferred stockholders "cannot complain."

### CONCLUSION.

**The decree of the Commerce Court should be reversed and the enforcement of the orders and regulations in question should be enjoined.**

SAMUEL UNTERMYER,  
WALTER C. NOYES,  
ARTHUR M. WICKWIRE,  
IRWIN UNTERMYER,  
*Appellant's Counsel.*

BRIEF

FOR

THE

UNITED

STATES

FILED OCT 22 1913

U.S. DEPT. OF JUSTICE

OCT 22 1913

JOSEPH H. BARNETT

No. 573

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# In the Supreme Court of the United States

OCTOBER TERM, 1913

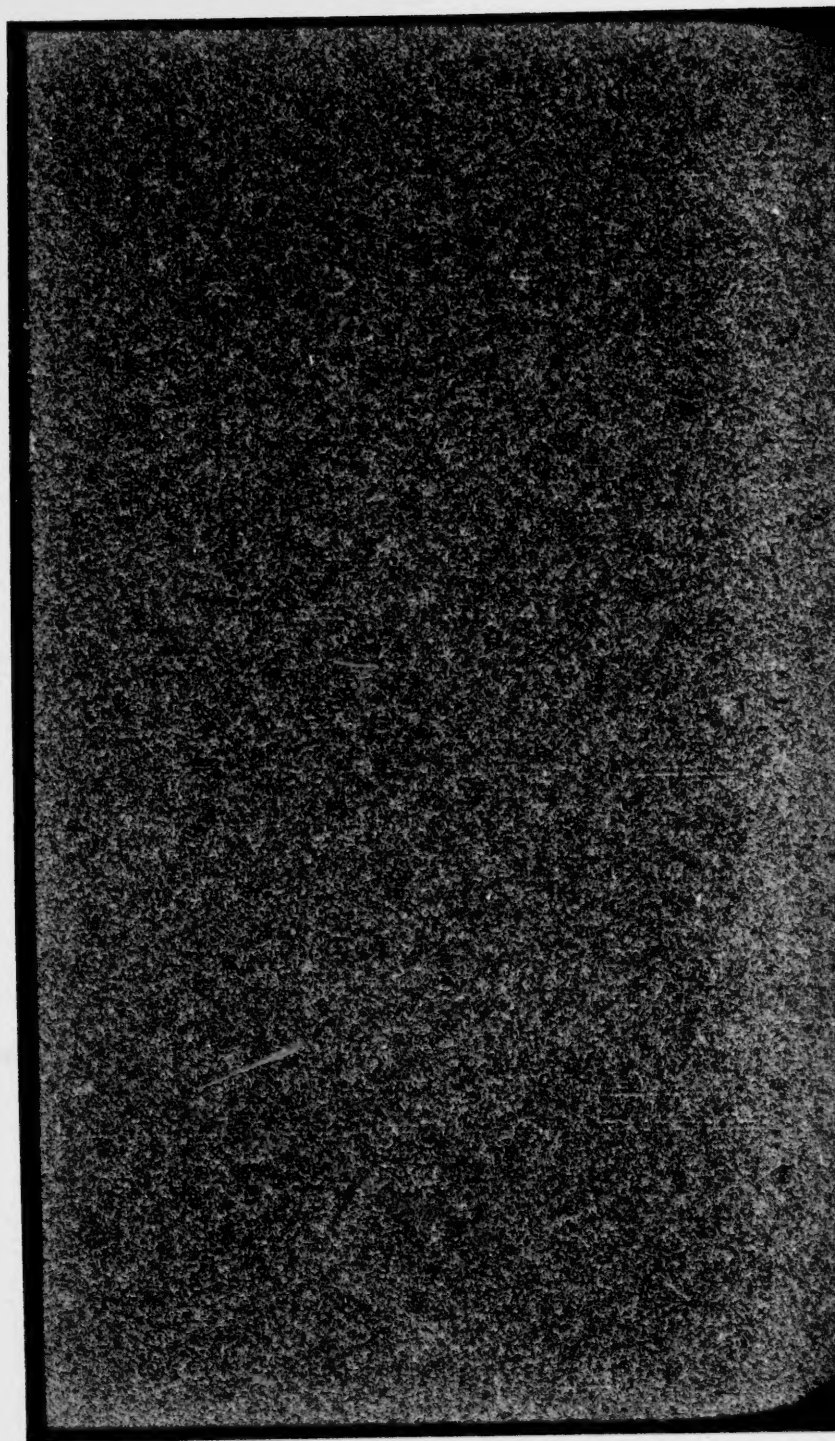
THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
APPELLANT,

THE UNITED STATES AND THE INTERSTATE COM-  
MERCE COMMISSION

AS APPEAL FROM THE DISTRICT COURT

BRIEF FOR THE UNITED STATES

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# In the Supreme Court of the United States.

OCTOBER TERM, 1913.

THE KANSAS CITY SOUTHERN RAILWAY Company, appellant, <i>v.</i> THE UNITED STATES AND THE INTERSTATE Commerce Commission.	}	No. 571.
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*ON APPEAL FROM THE COMMERCE COURT*

## BRIEF FOR THE UNITED STATES.

The opinion below (Tr., Vol. I, pp. 213-219) is reported in 201 Fed., 611.

Section 20 of the act to regulate commerce is given in appellant's brief (pp. 22-23).

The pertinent portions of the commission's classifications and general balance sheet are printed in an appendix to this brief.

### The First Ground of Complaint.

Appellant's original right of way having, by reason of its heavy grades, become incapable of handling economically the increasing traffic (Tr. Vol. II, p. 43), it revised its line to reduce the grades.

The particular portions of this operation which are involved in this case are six sections in which new

pieces of line were built on different locations from the old sections at a total cash expenditure of \$634,183.74<sup>1</sup> (Tr. Vol. I, p. 29).

The six old pieces of line were abandoned. Their replacement value, less salvage, was \$482,953 (Tr. Vol. I, p. 29).

Under the commission's classifications, this transaction must be recorded in the company's accounts in the manner shown in Exhibit B to the petition (Tr., Vol. I, p. 29), which includes the requirement that the abandoned property must be written out of the capital account and charged off to operating expenses, or, if too burdensome as an immediate charge, then suspended over such a series of years as the commission may prescribe.

The appellant claims that in making these requirements the commission exceeded its authority both (1) in requiring the abandoned property to be written out of the capital account, and (2) in requiring it, if so written out, to be charged to operating expenses.

### The Second Ground of Complaint.

A second ground of complaint is alleged (Tr., Vol. I, p. 24) in respect to a shop and terminal plant at Shreveport, which was abandoned, also because of obsolescence and inadequacy, and replaced by a new and enlarged shop and terminal plant on a different site.

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<sup>1</sup> The figures used are those of the petition. The subsequent experience made some difference, but none which matters here. (Appellant's brief, 6-7.)

This transaction the commission's classification requires to be recorded in the same way as the other.

The appellant, however, proposes to deal with it differently. It makes no question of the propriety of withdrawing this portion of the abandoned property (less salvage) from the property accounts, but contests (as in the other cause of action) the power of the commission to require it to be charged to operating expense rather than to profit and loss.

#### The Question.

*Interstate Commerce Commission v. Goodrich Transit Co.* (224 U. S., 194) settled the right of Congress to grant to the commission this power to prescribe accounts, and therefore the only question here is whether the grant has been exceeded.

In dealing with such a question it is important to keep in mind that the function of the commission in this class of matters is not even quasi judicial, but exclusively administrative, and so open to no review in any matter of opinion (*Illinois Central case*, 215 U. S., 452, p. 470; *Buttfield v. Stranahan*, 192 U. S., 470; *U. S. v. Grimaud*, 220 U. S., 506, 515-517; cf. *Union Pacific case*, 222 U. S., 541, 547).

The sole question is whether the commission's orders are both arbitrary as matters of accounting and injurious. Appellant's counsel, in effect, recognize this and plant themselves upon the proposition that the orders really are of this character.

## FIRST POINT

In requiring that abandoned property (over and above salvage) should not be continued as an asset the commission was not acting arbitrarily or injudiciously.

The theory of the commission is as Mr. Lutz expressed it (Rec., Vol. II, p. 766):

that the asset account for property used in operation should show the cost of, or the investment of the carrier in, only such property as an appraiser who might be called upon to value the property of the carrier would find in making a physical examination.

See also Rec., Vol. II, pp. 283, 284.

The fundamental purpose of section 20 being to afford a basis of information for rate making, *Interstate Commerce Commission v. Goodrich Treadwell Co.*, 224 U. S., 191, p. 211, appellant's brief, p. 289 and the basis of rate making being the value of the property "then employed" in carrying the rates (*Chenault v. Kentucky Water Co.*, 212 U. S., 1, 13; *The Maine de Bait Case*, 230 U. S., 362, 434; the Physical Valuation Law, 37 Stat. L., 7013), it would seem to follow inevitably that property lost by abandonment (dwnx), of course, excepting the salvage, should not be continued on the books as assets, and that the commission's action was not merely within a fair discretion but absolutely right.

Appellant's claim is purely a claim to an inflation of capital with water, thereby affording an opportunity to misinform security holders as to the extent of property behind their securities and an opportunity to misinform the commission as to the extent of property on which they should be entitled to earn rates.



If pursued it would require all future generations to pay interest upon property long since utterly consumed.

The conclusion of the commission is in accordance with the approved practice of the American railroads generally. (See the evidence cited under the next point) and has resulted in a capitalization in this country of less than \$60,000 per mile as against \$260,000 per mile in England, where the accounting system used by appellant as to the abandoned roadway has prevailed. (Ex. Vol. II, pp. 349, 351-352) and Report of Railroad Securities Commission, pp. 34-35.

It is true, however, that the old roadbed is really a part of the cost of the new track as paper that goes into the waste basket is part of the cost of the ultimate printed matter, so also is a part of the cost of the house. (Ex. Vol. II, 48.)

The *they* mean only as to the pieces of abandoned roadbed and not as to the abandoned shop and terminal at Silver Spring, which *they* concede to be properly withdrawn from the account of assets. (Ex. Vol. p. 46.)

Who this difference is? Evidently solely upon a question of facts, and if so, it is a question for the expert evidence and not for the court.

Paraphrasing, where the line lies between the waste paper which *we* concede to be part of the cost of a book and the abandoned shop which *they* concede not to be part of the cost of the new shop, and on which side of the line the abandoned roadbed lies—is it not

a pure question of fact for the decision of the commission?

But assuming the court will look at it, a simple and conclusive test is this: A purchaser on foreclosure of the railroad as it stands to-day would not pay for the abandoned roadbed, except at its salvage value; nor would a mortgagor loan money on it; and if it were covered by a prior mortgage, that mortgage has lost so much security.

They also argue that if, instead of relocating on new lines, they had cut down the old grade (which would have cost twice as much), they could have added the whole cost of the work to the property account without deduction (Brief, p. 12), from which they seem to conclude something not very clear, but presumably, judging from the argument below, either that it is an unreasonable inconsistency in the rules or an improper hardship to put them under the temptation to take the wasteful course.

There is no inconsistency and no hardship. If they choose to dig down from the summit to the base of a mountain to eliminate the grade from their line they have, of course, increased the cost of that line, in that location, and, extravagant though it may be, the new outlay is in fact an addition to their capital cost. They have lost no piece of property, though they may have wasted a great deal of money improving an old piece. Whereas if they abandon altogether the uneconomic right of way over the mountain and get a new right of way around it, they have

lost one article which was uneconomic and acquired another which is economic and profitable.

If their object is a solid and conservative property, rather than an extravagantly overcostly one, they will not complain of "hardship" in their choice. (Farrington's testimony, Vol. II, p. 300.)

## SECOND POINT.

Nor did the commission act arbitrarily and injuriously in requiring that property abandoned in connection with improvements should be charged off through operating expense instead of through surplus.

## I.

If this abandoned property is charged to surplus it is an immediate dead loss to the stockholders, whereas if it is charged to operating expense it remains, until satisfied, as a basis for rate charges. (Rec., Vol. II, 382, 311.)

This is the policy of the commission's order (Vol. II, 382), and it is an indulgence to the railroads as against the public, due to the fact that the abandonment might have been provided for in advance by a reserve fund out of earnings and so have justified higher rates in the past during the period of its actual depreciation. (Vol. II, 380.)

The commission concluded (and upon amply sufficient reason, as we shall show) that depreciation due to inadequacy or obsolescence, "*functional depreciation*" as it is sometimes called (Whitten, *Valuation of Public Service Corporations*, sec. 450, *infra*), is just as

properly an element of operating expense as "*physical depreciation*"; and where convenient, should be provided for by a sinking fund created out of the earnings of the property during its period of productivity. And such a sinking fund is provided for, at the option of the carrier (Rec., 266), in the system herein attacked.

The practical difficulties in the way of such a sinking fund led the commission to modify the strict rule to this extent, however, that where a carrier has not established such a sinking fund it may, when the time comes, abandon the superseded property for other adequate property, and insert all this accumulated depreciation into *current or future* operating expenses. This concession is justified (1) by the fact that the future operating expenses are decreased by the improvement; (2) by the fact that the functional depreciation is going on continuously, and evens up in the long run, the present burdening of operating expenses for past depreciation being offset by present functional depreciation which will not figure in the operating expenses till some day in the future; and (3) by the fact that it is not unreasonable that the present and future users of the public facility, in whose interest the old facility was abandoned, should through the higher rates fill up the hole in the assets caused by the abandonment.

In other words, these regulations make functional depreciation a part of the cost of maintaining the plant, and recognize the right of all railroads to fix their rates at a point which will make each genera-

tion pay the cost of its own progress as that progress occurs. (*Re Advances in Rates, Eastern Case*, 20 I. C. C., 243, 271.)

Nevertheless, the appellant argues that depreciation due to obsolescence is not a proper charge to operating expense, and that in so treating it the commission is compelling falsehood and so abusing its power.

This is a question of definition of the term "operating expense," and it was for the commission, acting within reasonable bounds, to establish the definition.

It is clear from the testimony in this case that no *universally* accepted definition of these words existed prior to the time the regulations herein complained of were prescribed, nor was the practice of the various roads uniform in regard thereto. The *very purpose* of the act which gave to the commission the power to prescribe a system was to *compel* such uniform definitions where none had theretofore existed. As was said by the committee appointed by the English Board of Trade under the railway regulation acts, in a passage quoted with approval in the *Goulden case* (221 U. S., at 212):

It is obviously of first importance from the point of view of comparison between the different railway companies that there should be uniformity of practice among all the companies with regard to the keeping of accounts and statistics; that is to say, that *every heading, both in the accounts and in the statistics, should bear precisely the same meaning in the case of all railways—should, in effect, be standardized.*

The establishment of a uniform series of definitions was exactly what the commission was to do, and in doing so as to this item it did not adopt any unheard-of accounting principles but merely those definitions of property accounts and operating expenses which were already recognized by many railroads, which were approved by many expert accountants, and which seemed to the commission best adapted to the American method of railroading.

No one who has read the testimony in this case, and particularly that of Mr. Lutz or Mr. Adams, can fail to appreciate the careful attention which the commission and its expert advisers gave to the very definitions involved in this case (functional depreciation and the treatment of abandoned property) and in this connection we invite particular attention to the history as outlined by Mr. Lutz on pages 224-279 of the record, Vol. II.

On the question of the reasonableness in fact of the commission's conclusion, we invite attention to the following matters which support its definition.

(1) Many of the best-managed railroads were already using accounting systems in which functional depreciation was, in some form or other, treated as an operating expense, either as in the case of the *Atchison, Topeka & Santa Fe* (Rec., Vol. II, pp. 322, 327), by a system like that prescribed by the commission, in which property abandoned for inadequacy is written off through operating expenses, or, as in the case of the *Great Northern* (Rec., II, p. 293) and many other railroads (Rec., II, pp. 343, 353),

by charging betterments directly to operating expenses, in which case no need of writing out of the property account the cost of the abandoned property would ever arise.

(2) The committee of twenty-five, a committee of expert railroad accountants chosen by the Association of American Railway Accounting Officers for the express purpose of assisting the commission in this very matter (Rec., II, 224), in a tentative classification prepared and adopted by that committee at Buffalo, N. Y., June 13 and 14, 1907, proposed a system of regulations which, as to the matters here disputed, was substantitally identical with that finally promulgated by the commission. (Rec., II, 238, 247, 248.) The importance to be attached to the subsequent modification of that portion of the tentative classification at the Atlantic City meeting July 6-9, 1908 (Rec., II, 249), and whether or not this change in attitude was brought about by pressure of superior executive officers, rather than by any change in the personal opinions of the committee as expert accountants (Rec., II, 253), was clearly a question peculiarly within the jurisdiction of the commission itself. It is noteworthy also that the changes in the tentative classification at the Atlantic City meeting were brought about by "rather a close vote" (Rec., II, 255), and that the tentative classification as finally approved by the Atlantic City meeting continued to treat functional depreciation as an operating expense in the case of bridges, rails (where weight has to be increased), interlocking apparatus, block signals, tele-

graph and telephone lines, *station buildings and fixtures, shops, engine houses and turntables, shop machinery and tools* (Rec., II, 266-269, 277-278, Appendix 22-26), making track the sole exception from the general principle.

(4) In reply to its request for criticisms and suggestions, the officers of various railroads, and also Price, Waterhouse & Co., chartered accountants, wrote letters to the commission approving the system of accounting then tentatively proposed and now finally adopted. (Rec., II, 233, 244, 245.)

(These letters were offered in evidence, but excluded subject to exception. Rec., II, 245.)

(5) The advice of the commission's own expert counselors, Mr. Adams, whose reputation as an economist is a matter of public knowledge and whose experience is described (Rec., II, 345); and Mr. Lutz, for 20 years an expert railroad accountant and for 7 years prior to his employment by the commission the assistant comptroller of the Louisville & Nashville Railroad. (Rec., II, 224.)

(6) The testimony of Mr. Adams in the Commerce Court. (Rec., II, 360, 362, 353.)

(7) The testimony of Mr. Lutz in the Commerce Court. (Rec., II, 286, 266, 264.)

(8) The testimony of Mr. Farrington, vice president of the Great Northern Railway. (Rec., II, 291, 292, 293, 300.)

(9) The testimony of Mr. Bailey, general auditor of the Atchison, Topeka & Santa Fe Railway. (Rec., II, 320, 322, 324.)



(10) The State railroad commissions have prescribed accounting systems similar to the one in question. This is shown by the express testimony of both Mr. Lutz (Rec., 279) and Mr. Adams (Rec., 357), and is not controverted.

(11) *Whitten on Valuation of Public Service Corporations*, the latest and one of the best books on the subject, devotes an entire chapter to the question of "functional" depreciation (depreciation due to obsolescence or inadequacy), and "supersession," the replacement of inadequate or obsolete facilities. In this chapter (Ch. XIX) he takes the position contended for by the Commission and the United States, that expenditures to make good this depreciation, by way of sinking funds or otherwise, are maintenance charges and hence operating expenses. The treatment is too long to be here copied *in extenso*, but we call the attention of the court particularly to sections 450, 451, 452, 453, 458, and 481.

(12) The court in *Knorrville v. Knorrville Water Co.* (212 U. S., 1, 13), *supra*, was clearly of opinion that functional depreciation is an operating expense, and therefore refused to permit the water company to include in the valuation of its property for rate purposes the value of property abandoned because of obsolescence. Mr. Justice Moody said at page 13:

We are also of the opinion that the master and the court erroneously excluded evidence which had an important bearing upon the true earning capacity of the company under the ordinance. A clear appreciation of this error

can be best obtained by a comprehensive review of the hearing. The company's original case was based upon an elaborate analysis of the cost of construction. To arrive at the present value of the plant large deductions were made on account of the depreciation. This depreciation was divided into complete depreciation and incomplete depreciation. The complete depreciation represented that part of the original plant which through destruction or obsolescence had actually perished as useful property. The incomplete depreciation represented the impairment in value of the parts of the plant which remained in existence and were continued in use. It was urgently contended that in fixing upon the value of the plant upon which the company was entitled to earn a reasonable return the amounts of complete and incomplete depreciation should be added to the present value of the surviving parts. The court refused to approve this method, and we think properly refused.

Accord: *Cumberland Tel. & Tel. Co. v. City of Louisville* (187 Fed., 637, 652-656; *San Joaquin County v. Stanislaus County* (191 Fed., 875, 886).

(13) The Public Service Commission of New York requires a charge to operating expenses sufficient to cover depreciation not only from wear and tear but also from obsolescence and inadequacy, and the principle is upheld, citing the *Knoxville case, supra*, in *People ex rel. Brooklyn Heights Railroad Company v. Tax Commissioners*. (69 N. Y. Misc., 646, especially p. 655.)

Accord: *People ex rel. Queens County Water Co. v. Woodbury* (67 Misc., N. Y., 490, 493), where Judge Blackmar said:

A loss due to functional depreciation is incurred in the operation of the business and therefore should be charged as an expense of operation. (*City of Knoxville v. Knoxville Water Co.*, 212 U. S., 1.)

See, to the same effect, the excerpt from Commissioner Maltbie's opinion in *In re Queens Borough Gas & Electric Co.* (2 P. S. C., 18th D. N. Y.), reported in *Whitten on Valuation of Public Service Corporations*, section 487, especially page 415, and the excerpts from the opinion in the *Third Avenue Reorganization* (2 P. S. C., N. Y., July 29, 1910), given in *Whitten*, section 463.

See also the report of Bion J. Arnold, a consulting engineer, who made a valuation of the Coney Island and Brooklyn Railroad for the New York Public Service Commission in a rate case. This report proceeded upon the theory that "obsolescence—and inadequacy, due to the growth of business—are examples of depreciation." (*Whitten, Valuation of Public Service Corporations*, sec. 403.)

(14) Functional depreciation was deducted in the *Holyoke, Massachusetts, Purchase case*. (*Whitten, Valuation of Public Service Corporations*, p. 385.)

(15) In *Columbus Ry. & Light Co. v. City of Columbus*, a Federal Circuit Court case, unreported except in *Whitten* (secs. 428 and 453), the special master appraising the plant for municipal purchase, while

making no allowance for physical depreciation, did, in fact, deduct for depreciation due to obsolescence and inadequacy.

(16) Such a principle was apparently recognized in the appraisal of the Spokane and Inland Empire Electric Railroad system by the public service commission of Washington. (*Whitten*, sec. 457.)

(17) The Wisconsin Railroad Commission in the case of *State Journal Printing Co. v. Madison G. & E. Co.* (4 W. R. C. R., 501; *Whitten*, sec. 486), says:

\* \* \* Undoubtedly such losses as wear and tear, abrasion, corrosion, deterioration due to time and the elements, and other items of this character, are a *part of the cost of producing the services rendered, and should therefore be borne by the consumers.* This would also seem to be true of obsolescence due to progress in the art, especially when the cost resulting therefrom is not offset by increased efficiency evidenced either by increases in the earnings or reductions in the operating expenses. *Inadequacy due to the growth of the business, particularly when it results in net losses to the utility, would also seem to come in this class.*

(18) Montgomery on Auditing, Theory, and Practice (ed. 1912, p. 319) supports the commission.

In the face of this support, it is impossible to denounce the action of the commission as beyond reason and so beyond its authority.

## II.

But, it is argued, the rule will deprive the preferred stockholders of dividends, which are noncumulative and so irrevocably lost. Even if this were true it means nothing more than that they must suffer a normal and proper consequence of a loss of property. (Opinion below, Tr. Vol. I, p. 218; *Molloy's case*, 219 U. S., 486.)

The point, however, is based on the hypothesis that the commission will refuse to exercise the alternative it has declared in the rules, by which if the charge would "unduly burden" the operating expense account for a single year they will permit its suspension over a series of years. (Appendix 21, 28-29.)

If, for instance, the commission should spread the charge over 10 years, it would amount to only \$38,600 a year, which would have no appreciable effect upon the net balances carried to profit and loss, averaging each year from 1907 to 1911, inclusive, over \$900,000. (Rec., Vol. II, p. 272.)

There is even no reason to suppose the commission would require an annual charge greater than the annual net saving from the improvement itself, which is one-half of the old cost of train movement. (Bart's Report, Rec., Vol. II, p. 15; Loree's testimony, Rec., Vol. II, p. 43.)

The whole thing, however, is entirely hypothetical, and the appellant, having not yet applied to the commission to spread this charge, has no right to attack the rule itself as arbitrary and unreasonable when it promises action which would not be so.

## III.

Finally, it is argued (Brief, p. 32) that the rule is a wrongful interference with the management because, as is said, it "vetoes" the agreed use of the proceeds of the bond issue to the extent of the \$400,000 (\$386,000) and requires that amount of such proceeds to go into operating expense and then back to the trustee of the mortgage.

In fact, as the accounts will show (Exhibit B. to the Petition Transcript, Vol. I, p. 29), the whole proceeds of the bond issue are paid in the expense of the new construction, which is precisely what was agreed to under the mortgage. The abandoned property is carried in suspense until paid for out of earnings. (Farrington, Rec., Vol. II, p. 302; Bailey, Rec., Vol. II, pp. 317-318; opinion below Vol. I, p. 218.)

## CONCLUSION.

The judgment should be affirmed.

WINFRED T. DENISON,

*Assistant Attorney General.*

THURLOW M. GORDON,

*Special Assistant to the Attorney General.*

OCTOBER, 1913.

## APPENDIX.

### EXTRACTS FROM THE CLASSIFICATIONS.

#### I.

**From the Classification of Expenditures for Additions and Betterments (First Revised Issue, effective July 1, 1910; Exhibit B, Answer of the Commission).**

#### GENERAL INSTRUCTIONS.

1. **Application of this classification.** This classification should be so applied as to reflect the net increase or decrease (determined according to the rules provided) in the investment of a carrier in such property as is used in the operation of railways as transportation agencies, including outside operations incidental to furnishing transportation. Entries in the accounts prescribed in this classification should be made only with respect to additions to, betterments of, and withdrawals and retirements of property composing the plant and equipment of existing main and branch lines, including sidings and spur tracks, and the necessary buildings, structures, and facilities.

4. **Property retired and replaced.** When property (other than land or equipment), a betterment of which would be chargeable to the accounts of this classification, is abandoned, demolished, or otherwise retired from service for the purpose of or by reason of its replacement by property of like purpose of a better kind or a higher type the cost of replacing in kind the property so abandoned or withdrawn from service, less the salvage, if any, should be charged to Operating Expenses. If, however, a reserve for abandonment, as provided in paragraph 8 of these instructions, or a reserve for accrued depreciation has been created with respect to such property, the reserve account should be first debited with an amount equal to the credits thereto made with respect to the property abandoned or

withdrawn and replaced; but if no reserve has been created in advance of the retirement of such property and the amount chargeable to Operating Expenses is relatively large, so much of the amount as may be authorized under the conditions outlined in paragraph 9 may be carried in suspense for distribution to the operating expenses of succeeding years.

**5. Property retired and not replaced.**—When property (other than equipment), an addition to or a betterment of which would be chargeable to the accounts of this classification, is abandoned or withdrawn from service and not replaced, the cost (estimated, if not known) should be credited to the account provided herein for such property; proper account should be taken of any salvage; the reserve accounts for abandonment and accrued depreciation should be debited with the amounts, if any, previously credited thereto with respect to the property abandoned or withdrawn, and the difference between the salvage plus the reserves and the cost should be charged to Profit and Loss, to which should also be charged any incidental expenses connected with the retirement.

**6. Land sold or abandoned.** If any land, except land the cost of which may be classified under "Miscellaneous Investments" in the Form of General Balance Sheet Statement, First Revised Issue, is abandoned or its use discontinued, the original cost of the land (estimated if not known) should be credited to the appropriate accounts under Additions and Betterments and charged, less salvage from sale or other disposal, if any, to Profit and Loss. If the land is retained by the carrier, it should be charged at a fairly appraised value to an appropriate account to be included under "Miscellaneous Investments" in the Form of General Balance Sheet Statement, First Revised Issue.

**8. Reserves for abandonments.** If so authorized upon application to the Interstate Commerce Commission, a carrier may set up accounts under Maintenance of Way and Structures in Operating Expenses with respect to important pieces of property (except equipment) to be abandoned, for the purpose of creating such reserves as will, at the time of the abandonment, meet or reduce the amounts



otherwise chargeable to Operating Expenses or to Profit and Loss. Upon the abandonment of any property with respect to which a reserve has been created, such portion of the amount otherwise chargeable to Operating Expenses or to Profit and Loss as will equal the amount previously credited to the reserve account should be debited thereto.

**9. Distribution of charges for abandoned property.**—In case the amount chargeable to operating expenses for property abandoned directly in connection with improvements is relatively large, and its inclusion in a carrier's operating expenses for a single year would unduly burden those accounts for that year, a carrier may, if so authorized upon application to the Interstate Commerce Commission, charge so much of the cost as may be authorized to an account "Property Abandoned, Chargeable to Operating Expenses," as provided in the Form of General Balance Sheet Statement, First Revised Issue. The amount so charged should thereafter be apportioned to the operating expenses of succeeding years, the number of which will be determined when permission to use the account is given.

#### TEXT OF CLASSIFICATION.

##### A 5. GRADE REDUCTIONS AND CHANGES OF LINE.

To this account should be charged:

For grade reductions (cutting down summits and raising sags without materially changing the alignment): The cost of additional grading, including the cost and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, or streets, including crossing gates, alarms, and watchhouses; less the cost of replacing in kind grades or other property abandoned or removed.

For changes of alignment (alteration of alignment for the purpose of reducing curvature, cutting out bridges, tunnels, etc.): The excess cost of the grading, bridging, tunneling, etc., necessary for the change, over the cost of replacing in kind the grade, bridges, tunnels, etc., abandoned.

For changes of line (construction of new lines for the purpose of improving grade or alinement): The difference between the cost of the new line and the cost of replacing in kind the line abandoned, excluding the cost of right of way for both lines, but including the cost of engineering, clearing, grubbing, and grading; tunnels, bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools, rent and cost of operation of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

NOTE A.—The cost of such grading as is necessary to restore banks or cuts to the original width, slope, and grade; raising, lowering, and shifting tracks; keeping tracks in repair and in condition for handling traffic during the progress of the work, including the cost of protecting traffic while passing over the tracks; reballasting, lining, and surfacing tracks on completion of the work; moving and replacing riprap or other bank protection, and moving and relocating telegraph or telephone poles, signals, fences, buildings, etc., should all be charged to the appropriate operating expense accounts.

NOTE B.—The cost of buildings, water and fuel stations, and similar structures on a changed line should not be charged to this account, which is intended to cover the roadway and track only, but should be charged to the appropriate accounts herein provided for the different classes of buildings and structures.

#### A 6. TUNNEL IMPROVEMENTS.

To this account should be charged the excess cost of enlarged tunnels (except to provide for additional main tracks) over the cost of replacing in kind the smaller tunnels; the excess cost of lining tunnels with stone, brick, or concrete over the cost of replacing in kind a less durable lining removed; and the cost of ventilating and lighting apparatus

and of other safety devices, except guard rails and signals, added to tunnels.

NOTE. —If a tunnel is converted into an open cut, the cost of clearing, grubbing, and excavating (including the cost of disposing of the excavated material) should be charged to account A 3, "Widening Cuts and Fills." The cost of removing the lining of the tunnel, of protecting tracks and trains while the lining is being removed, and of restoring the tracks to proper condition for operation should be charged to the appropriate operating expense accounts.

#### 7. BRIDGES, TRETTLES, AND CULVERTS.

To this account should be charged the excess cost of new bridges, trestles, and culverts carrying tracks over streams, ravines, streets, or other railways, over the cost of replacing in kind bridges, trestles, or culverts removed or abandoned, including the cost of abutments, piers, supports, draw and pier protection; machinery to operate drawbridges; guard rails; inspection of material; tests; wing walls to abutments and culverts, masonry or concrete ends for culverts, riprap at culvert ends or around abutments; piers, dams, cribs, ice breakers; and painting (except repainting). It includes, also, the cost of additional parts or appurtenances and the excess cost of improved parts or appurtenances of bridges, trestles, and culverts over the cost of replacing in kind parts or appurtenances removed.

NOTE A. The cost of removing old material and protecting traffic during improvements should be charged to Operating Expenses.

NOTE B. When a bridge or trestle, or part of a bridge or trestle, is converted into a fill the cost (estimated, if not known) of the bridge or trestle if completely filled, or of such part of it as may be filled, should be credited to this account and charged, less salvage, to Operating Expenses. Such part of the original structure as would equal in cost the temporary trestling that would have been necessary to the construction of the fill in the first instance should be considered as salvage. The cost of filling, including

such salvage, should be charged to account A 3, "Widening Cuts and Fills."

The cost of constructing bridges, trestles, or culverts where none previously existed, made necessary by the stopping up of natural waterways by the construction of embankments, should be charged to this account; the cost of that part of the embankment removed being credited to account A 3, "Widening Cuts and Fills," and charged to the appropriate operating expense account, which should also be charged with the cost of removing the embankment.

NOTE C. When the construction of new bridges, trestles, or culverts is made necessary by reason of grade reductions or changes in line or the building of additional main tracks, sidings, spur tracks, or terminal yards, or by such work as elimination of grade crossings, or reconstruction of road purchased, the cost thereof should not be included in this account, but in the account under which is classified the cost of the work that makes necessary the construction of the bridges, trestles, or culverts.

#### A 8. INCREASED WEIGHT OF RAIL.

To this account should be charged the excess cost of heavier rails applied to existing tracks, over the cost of rails of the same weight as the original pattern of the rails replaced, the cost to be based upon the price per ton (including freight and inspection) of the rails used in relaying the tracks.

NOTE A. The cost of distributing, laying, spiking, and jointing rails, surfacing and lining track, and picking up and removing old rails should be charged to Operating Expenses.

NOTE B. In cases where the rails first applied to any tracks were second-hand rails and no more than the actual cost of such rails is carried in the accounts representing the cost of road and equipment, the excess cost of new rails or heavier rails used for relaying the tracks over the cost (at prices current at the time of replacement) of rails of a weight and condition equal to the weight and condition of the re-

leased rails, when applied, may be charged to this account.

NOTE C. If the rails released from a carrier's main tracks are utilized in relaying the tracks of its branch lines, sidings, or spurs, previously laid with rails of a lighter pattern, the entire salvage value of rails so applied, less salvage from rails so replaced, may be charged to Operating Expenses as renewals, if the carrier deems it proper so to do.

#### A 9. IMPROVED FROGS AND SWITCHES.

To this account should be charged the excess cost of heavier frogs and switches over the cost of replacing in kind frogs and switches removed, the charge to be based upon the excess weight of the frogs and switches put in, if bought by weight. If the frogs and switches are of an improved (or patented) type, the excess cost of such frogs and switches over the cost of replacing those removed with others of the same pattern should be charged to this account.

NOTE A. The cost of distributing new frogs and switches and picking up and loading frogs and switches removed in the course of betterment work should be charged to Operating Expenses.

NOTE B. No entry is required in this account with respect to improved frogs and switches unless they are installed under a definite plan of improvement, such as increasing the weight of rail.

#### A 10. TRACK FASTENINGS AND APPURTENANCES.

To this account should be charged the cost of additional track fastenings and appurtenances and the excess cost of heavier or improved track fastenings and appurtenances over the cost of replacing in kind similar material removed, such as anticeepers, anglebars, connecting rods, guard rails (except on bridges, trestles, and culverts), guard-rail clamps and fasteners, nuts, nut locks, rail braces, rail chains, rail slips, rail joints, splice bars, tie plates, and like material.

NOTE A. The cost of distributing and applying new track fastenings and appurtenances and of picking up and loading material removed in the course of betterment work should be charged to Operating Expenses.

**NOTE B.**—No entry is required in this account with respect to improved track fastenings and appurtenances, unless they are applied under a definite plan of improving the tracks.

\* \* \* \* \*

#### A 23. SHOPS, ENGINEHOUSES, AND TURNABLES.

To this account should be charged the cost of additional shops, enginehouses, and turntables, and of additional fixtures, facilities, and appurtenances (other than shop machinery and tools) necessary to equip them; also the excess cost of new buildings or structures or parts of buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind like property removed.

This account should include the cost of the following buildings or structures when built as parts of or for use in connection with shops, enginehouses, and turntables: Car sheds, cinder pits, drop pits, electric light and power plants, outhouses, sand houses, scrap bins, storehouses, tracks, and transfer tables; also the cost of the following items incidental to the construction or improvement of the buildings or structures mentioned: Architects' fees, beautifying grounds, excavations, foundations, electric fixtures, fences, gas fixtures, grading, heating plants and apparatus, hedges, platforms, sewerage systems, sidewalks; turntable levers, tractors, and stops; and water system connections.

**NOTE.**—The cost of restoring the condition of grounds after betterment work should be charged to Operating Expenses.

### II.

#### **From the Form of General Balance Sheet Statement (First Revised Issue, Effective June 15, 1910; Exhibit C, Answer of Interstate Commerce Commission).**

##### EXPLANATORY NOTE.

The accounts prescribed in the Form of General Balance Sheet Statement are, in some instances, net balances or the sums of balances from other accounts. It is not required that all the accounts prescribed in this classification shall be kept under the exact titles given to the accounts herein prescribed, but it is required that the accounts necessary to

record the transactions reflected herein shall be kept, it being permissible to keep such additional accounts as may be necessary to make any further analysis of the balance-sheet entries desired by the respondent company.

The term "cost or book value," as applied to various accounts representing securities owned, is intended to recognize the option of the respondent company of carrying its investments in securities either at cost or at a reasonable valuation other than cost. Whenever securities are acquired, they are to be entered on the books at cost. If, subsequently, the company desires to adjust their value on account of substantial appreciation or depreciation, the entries in its books with respect to such securities, as well as its annual reports to the Commission, should clearly show the reasons for making the adjustments.

Contingent assets and liabilities should not be included in the body of the balance-sheet statement, but should be shown in detail in a supplementary statement accompanying the balance sheet. Contingent assets represent possible sources of value contingent upon the fulfillment of conditions regarded as uncertain. Contingent liabilities include obligations which may, under certain conditions, become obligations of the respondent company but are neither direct nor assumed obligations on the date of the balance sheet.

#### TEXT EXPLANATORY OF ACCOUNTS APPEARING IN THE GENERAL BALANCE SHEET STATEMENT.

##### ASSETS.

##### PROPERTY INVESTMENT.

##### 1. Road and Equipment.

##### B 1-A. Investment to June 30, 1907.

This account should include the balances carried in the General Ledger showing the book value of Road and Equipment as it stood on June 30, 1907, subdivided between (a) Road and (b) Equipment, when the subdivision can be accurately made.

##### B 1-B. Investment since June 30, 1907.

This account should include the cost of all property, classifiable as Road and Equipment or Additions and Betterments, acquired since June 30, 1907,

less deductions for property abandoned. The amount included herein should be subdivided: (a) Road, (b) Equipment, (c) General Expenditures.

NOTE.—When any equipment is acquired under a so-called trust agreement or any agreement which provides that the cost shall be paid in installments, the cost (its cash value at time of purchase) should be charged to Additions and Betterments at the time of its acquisition and included in the foregoing accounts in the same manner as is the cost of equipment purchased outright. When the par value of notes or other securities issued in payment, or in part payment, for such equipment is more (or less) than the actual cash value of the equipment at the time of the purchase, or of the proportion to which the securities are applicable, the difference between the par value of the securities and the actual cash value of the equipment, or of the proportion paid for by the securities, should be credited (or charged) to the proper Discounts and Premiums accounts. (See account B 20.)

**B 1-c. Reserve for Accrued Depreciation—Cr.**

This account should include amounts charged, with respect to equipment or other property in service at the date of the balance sheet, to Operating Expenses (or to other accounts) to cover depreciation on such property.

\*\*\* The total of accounts B 1-A and B 1-B should be drawn down on the balance-sheet statement and the amount of account B 1-c deducted therefrom, the difference being shown as the total of Road and Equipment.

\* \* \* \* \*

**B 21. Property Abandoned, Chargeable to Operating Expenses.**

This account is intended as a suspense account to which may be charged certain costs representing important pieces of property abandoned because of

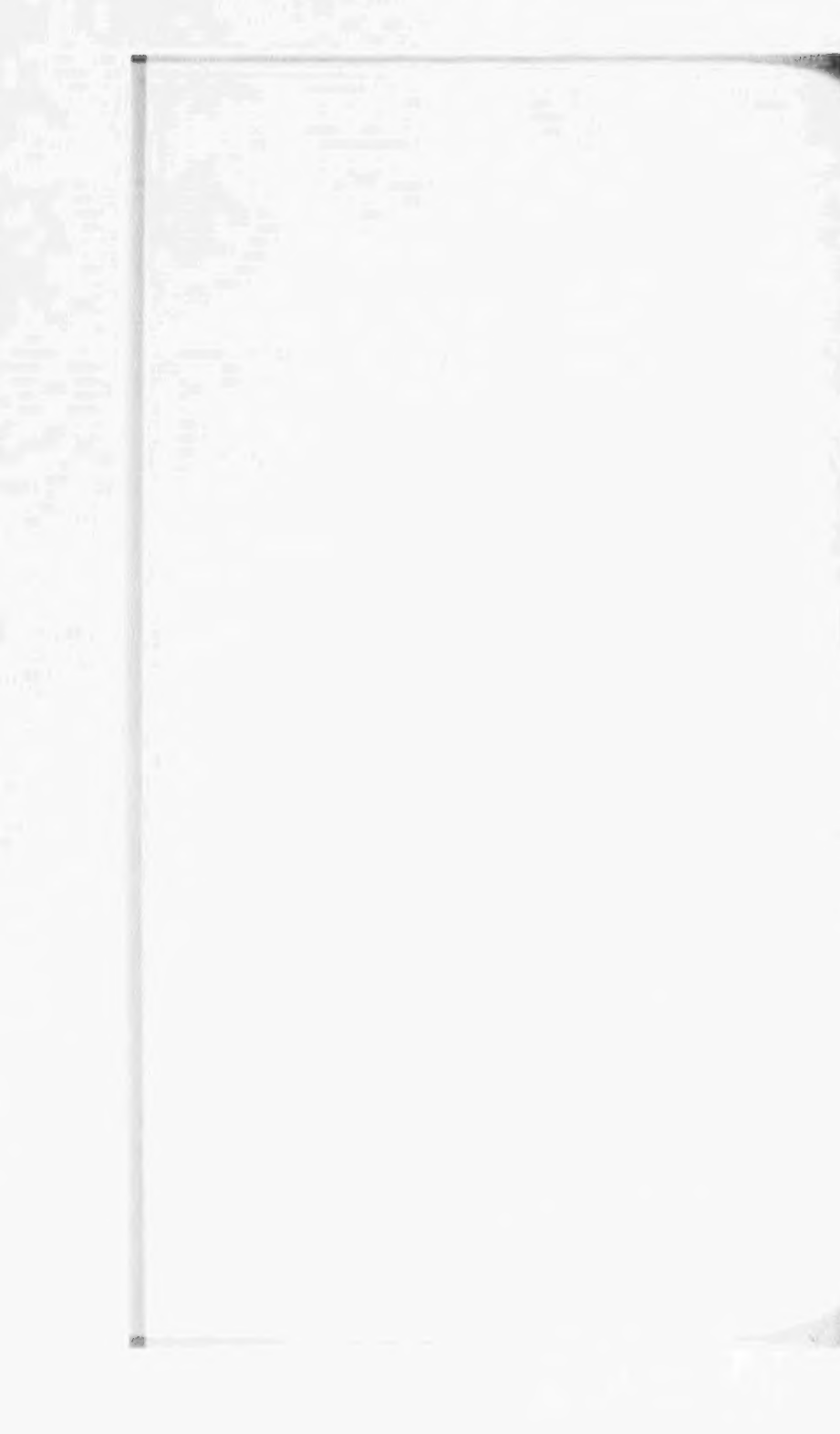


improvement or betterment work when the cost of such property would, if included in the operating expenses for a single year, unduly burden such accounts for that year. It is to be used only after permission of the Interstate Commerce Commission has been asked and given and is not to be applied to lands abandoned or to equipment retired from service. Amounts included in the account are to be redistributed to operating expenses through a period of years, the number of which will be determined when permission to use the account is granted, and the balance remaining unextinguished on the date of the balance sheet should be included herein.

To this account (when authorized by the Interstate Commerce Commission) may be charged such amounts as are required by the Classification of Expenditures for Additions and Betterments to be charged to operating expenses for property abandoned because of additions and betterments work.

NOTE.—The phrase "unduly burden such accounts," used above, should not be interpreted as meaning that a carrier is at liberty to make charges for abandoned property directly to operating expenses, or to operating expenses through the account "Property Abandoned, Chargeable to Operating Expenses," in view of its financial ability to make such charges directly in one year and its inability to make such charges in another year.





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Office Supreme Court, U. S.  
**FILED.**

OCT 17 1913

JAMES H. McKENNEY,  
CLERK.

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**In the Supreme Court of the United States.**

OCTOBER TERM, 1913.

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No. 571.

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,  
APPELLANT,

*v.*

THE UNITED STATES AND INTERSTATE COMMERCE  
COMMISSION, APPELLEES.

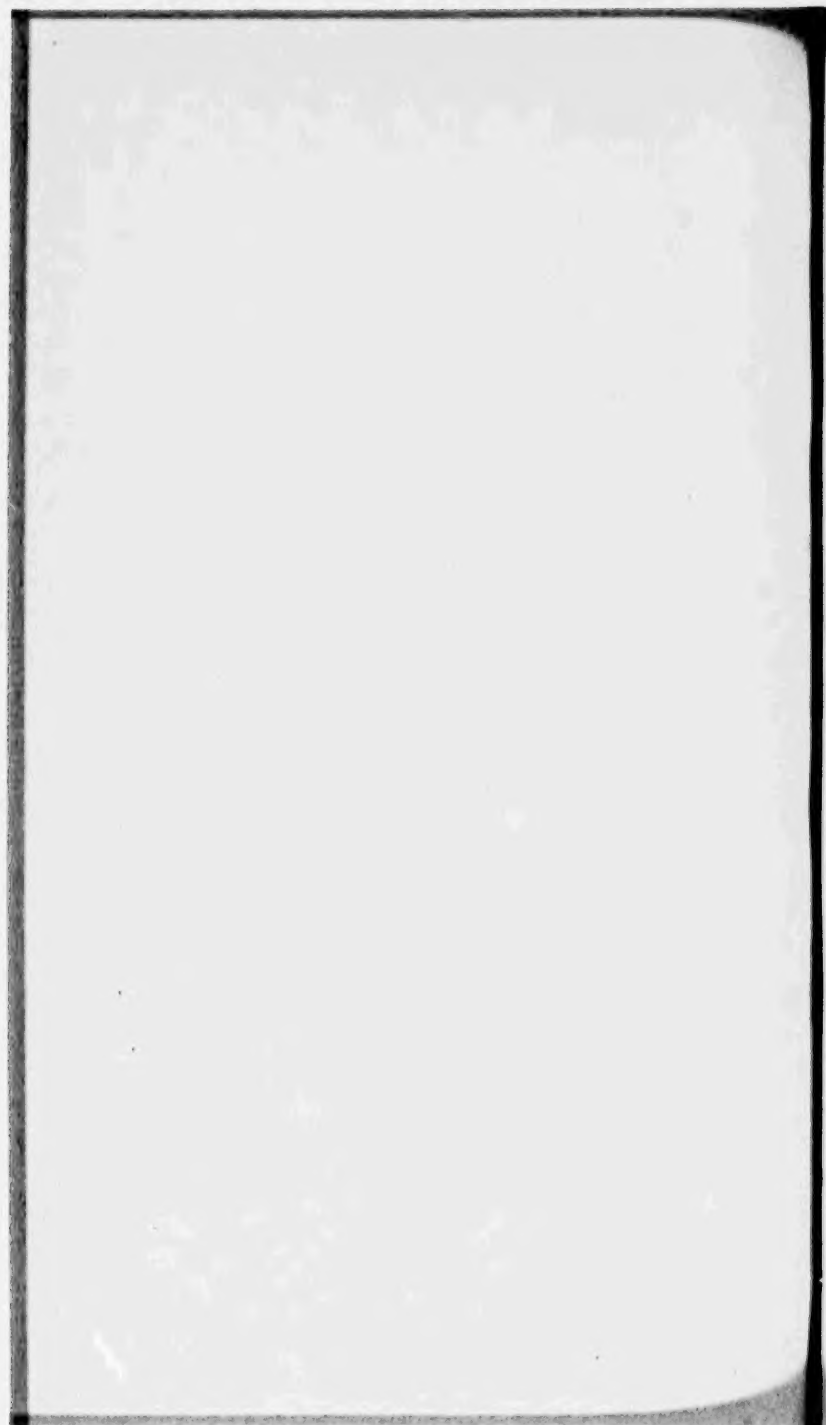
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*APPEAL FROM THE UNITED STATES COMMERCE COURT.*

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**BRIEF ON BEHALF OF INTERSTATE COMMERCE  
COMMISSION.**

**CHARLES W. NEEDHAM,**  
*Assistant Solicitor.*



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# In the Supreme Court of the United States.

OCTOBER TERM, 1913.

THE KANSAS CITY SOUTHERN RAILWAY Company, appellant, v. THE UNITED STATES AND INTERSTATE Commerce Commission, appellees.	}	No. 571.
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*APPEAL FROM THE UNITED STATES COMMERCE COURT*

## BRIEF ON BEHALF OF INTERSTATE COMMERCE COMMISSION.

### QUESTIONS INVOLVED.

The questions in this case are: May the Interstate Commerce Commission require carriers subject to the act who construct new roadbed upon a new right of way and abandon the old parts of their line thus replaced, or construct a new shop upon a new site and abandon the old shop (the new roadbed and shop to serve the same territory, traffic, and purpose), (1) to deduct from the cost of the new improvement the cost or replacement value of the abandoned property, less salvage, and permit them to

charge the balance only to property account (the account showing the cost of the road operated) and require them (2) to charge the cost or replacement value of the abandoned property, less salvage, to operating expenses?

Stated in another way, this rule, *in effect*, requires the carrier, in such a case, to deduct from or credit to the property account the amount of the cost or replacement value, less salvage, of property abandoned, and to charge the amount to operating expenses; the entire cost of the new property, constructed to take the place of the old in service, to be charged to the property account. This account so stated will then show the cost of the property actually operated.

*Special provisions.*—There are other provisions in the order (1) which permit the carrier to anticipate the loss of abandoned property by creating a special reserve out of earnings, to meet such losses when they occur; in which event the replacement value of the abandoned property may be charged to this special reserve account instead of to the operating-expense account; or (2) the carrier may, at the time the improvement is made, set up a special account for abandoned property, and, with the consent of the commission as to time and division, distribute the loss over a period of years, charging part of it each year, during the period fixed, to operating expenses. Both of these provisions are intended to mitigate the effect of charging an unduly large amount for abandoned property to operating expenses in any one year. In



each case, however, the loss is a charge to operating expenses; in the first instance it is taken out during a period of years preceding the loss, and in the second instance it is charged during a period of years succeeding the loss.

#### REASONS FOR THE RULE.

1. The property account is intended to represent the cost of the railroad property. Every item of cost (or the balance under this rule) in constructing the permanent railroad and structures connected therewith is charged into this account. The total charges therefore show the entire investment made by the stockholders. If there are withdrawals or abandonments of parts of the railroad or structures, the cost or replacement value of the parts so abandoned, less salvage, is credited to this account; the balance of the account at any time therefore shows the true cost of the railroad and structures existing at the time the balance is struck.

To maintain the integrity of this account, and show the total of the investments and withdrawals and a true balance, the cost or the replacement value of all abandonments, those not replaced in kind as well as those occasioned through replacement of new roadbed or structures, less salvage, must be credited to the cost or property account. The cost of new improvements being added to the account, a complete record of the transaction is kept and a balance at any time gives the true cost value of the road then operated.

2. These replacements of new roadbed and structures are occasioned by the inadequacy of the old roadbed or structures, at certain points, to serve the public satisfactorily. This inadequacy is one form of "depreciation," and all depreciation is chargeable to operating expenses.

A plant should be kept up to the standard of efficiency that will enable it to meet all normal and constant demands upon it. Losses of old materials and property, occasioned by meeting this efficiency demand in installing new machinery or constructing new parts, are operating expenses and should be borne by the current revenue before a true surplus or dividend can be declared.

3. In considering net revenues, as a fact in determining the reasonableness of rates for the public, only the true balance, above described, should be taken into account.

#### CONTENTION BY THE APPELLANT.

The appellant company, having made certain improvements involving abandonment of six pieces of its railroad, assails these particular requirements in the classification of accounts as arbitrary and beyond the power of Congress and the commission. It desires (1) to be permitted to allow the entire cost of the abandoned property to remain in the property account, or, (2) if required to take these items out of the property account, that it be permitted to charge the same direct to its profit and loss account.

*Prayers.*—The prayer of the petition is that the orders and classifications of the commission, in so far “as they may require or tend to require” the appellant “to charge against its earnings the estimated replacement value (less salvage) of \* \* \* six parcels of railroad abandoned \* \* \* and in effect prevent” the appellant “from carrying in its capital or property account the full undiminished cost (less net salvage) of the said grade revisions, to be declared unreasonable, without the power or authority either of Congress or the Interstate Commerce Commission, and in violation of the provisions of the fifth article of the amendments to the Constitution of the United States as a deprivation of property without due process of law and for said reasons null and void.” (Rec., Vol. 1, p. 26, petition, pp. 38–39.) The prayer regarding the estimated value, less salvage, of the old Shreveport shop abandoned, is that the net amount be charged to profit and loss.

#### THE ISSUES.

The issues thus clearly raised are: (1) the power of Congress under the Constitution to make or authorize this classification, and (2) the power of the Interstate Commerce Commission under the act to regulate commerce as amended to classify the accounts of carriers, to prescribe a uniform system of accounts, and to prescribe the form of an annual balance sheet. The first and fundamental question is one of power; the second question is whether the commission has

acted within the powers conferred; and a third, whether it has acted arbitrarily in promulgating and enforcing the rule in controversy.

#### STATEMENT OF FACTS.

*The legislation.*—The legislation by Congress involved in this case is found in sections 20, 12, and 24 of the act to regulate commerce as amended. These sections, among other things, provide (*italics* are for this brief):

SEC. 20. (*As amended June 29, 1906, February 25, 1909, and June 18, 1910.*) That the commission is hereby authorized to require annual reports from all common carriers subject to the provisions of this act, and from the owners of all railroads engaged in interstate commerce as defined in this act, to prescribe the manner in which such reports shall be made, and to require from such carriers specific answers to all questions upon which the commission may need information. Such annual reports shall show in detail the amount of capital stock issued, the amounts paid therefor, and the manner of payment for the same; the dividends paid, the surplus fund, if any, and the number of stockholders; the funded and floating debts and the interest paid thereon; *the cost and value* of the carrier's property, franchises, and equipments; the number of employees and the salaries paid each class; the accidents to passengers, employees, and other persons, and the causes thereof; the amounts expended for improvements each year, how expended, and the character of such

improvements; the earnings and receipts from each branch of business and from all sources; the operating and other expenses; the balances of profit and loss; and *a complete exhibit* of the financial operations of the carrier each year, including an annual balance sheet. Such reports shall also contain such information in relation to rates or regulations concerning fares or freights, or agreements, arrangements, or contracts affecting the same as the commission may require; and the commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this act, prescribe a period of time within which all common carriers subject to the provisions of this act shall have, as near as may be, *a uniform system of accounts, and the manner in which such accounts shall be kept.*

Said detailed reports shall contain all the required statistics for the period of twelve months ending on the thirtieth day of June in each year, or on the thirty-first day of December in each year if the commission by order substitute that period for the year ending June thirtieth, and shall be made out under oath and filed with the commission at its office in Washington within three months after the close of the year for which the report is made.

In reference to the duties and powers of the commission regarding the matters in controversy, section 20 further provides:

The commission may, in its discretion, *prescribe the forms of any and all accounts, records,*

and memoranda to be kept by carriers subject to the provisions of this act, including the accounts, records, and memoranda of the movement of traffic as well as the receipts and expenditures of moneys. The commission shall at all times have access to all accounts, records, and memoranda kept by carriers subject to this act, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the commission.

Section 12, among other things, provides:

SEC. 12 (*as amended March 2, 1889, and February 10, 1891*). That the commission hereby created shall have authority to inquire into the management of the business of all common carriers subject to the provisions of this act, and shall keep itself informed as to the manner and method in which the same is conducted, and shall have the right to obtain from such common carriers *full and complete information necessary to enable the commission to perform the duties and carry out the objects for which it was created; and the commission is hereby authorized and required to execute and enforce the provisions of this act.*

Section 21 of the act provides:

SEC. 21 (*as amended March 2, 1889*). That the commission shall, on or before the first day of December in each year, make a report, which shall be transmitted to Congress, and copies of which shall be distributed as are the other reports transmitted to Congress. *This report shall contain such information and data*

*collected by the commission as may be considered of value in the determination of questions connected with the regulation of commerce, together with such recommendations as to additional legislation relating thereto as the commission may deem necessary.*

*Organization of the work required of the commission by section 20.* The commission, recognizing the grave importance of the subject, both to Congress and the vast property interests involved, entered upon the duties devolved upon it by section 20 with great circumspection. In a general way, for many years prior to 1906, the classification of railway accounts had been the subject of study by the best economists and statisticians in the country. Organizations had been formed for this purpose, and the railroad companies had employed expert accountants to classify and supervise their accounts. The commission employed Mr. Henry C. Adams, then and now professor of political economy and finance of the University of Michigan, put him in charge of the statistical division of the commission, gave him a large corps of assistants and accountants, and began a careful investigation and study of the subject with a view of providing a classification of accounts, a uniform system of bookkeeping, and an annual balance sheet for carriers subject to the act that would be just and fair to the railroads and the public.

*The work of classification began in 1906.* The development of the specific classification in con-

troversy began after the Hepburn amendment in 1906 and continued for nearly three years before a conclusion was reached. While no formal hearing was provided for in the act, the commission, through the head of the statistical division, entered into correspondence with the carriers with a view to securing information as to existing methods of classifying accounts, the reasons for special methods of classification, and the general business policies reflected in the accounts. It should be constantly in mind that the commission acts for the public; it sought right methods in the classification of accounts without reference to the selfish or individual interests of particular railroads, or any class of railroads, and with a view to securing and giving to Congress reliable information upon which legislation could be based, and securing for itself the knowledge that would enable it to carry out the purposes of the act and make the regulation of rates fair both to the railroads and the public.

It should also be borne in mind that the classification of accounts, the bookkeeping, the balance sheets, and reports were to be a *uniform system*. Necessarily this uniform system could not represent all the different theories and views of the railroad executives. The commission undertook to survey the whole field and provide a system that would, as a whole, give a true record of all the financial transactions of the carriers, provide a complete statistical record of the physical and financial conditions of each railroad,



and give in each division of the accounts a balance, whenever struck, that would truthfully represent the then existing state of the finances, and the cost value of the physical property of each railroad. This is essential in determining the reasonableness of rates and charges. It was not a question of business policy but of public justice that became the controlling motive in this work.

*Cooperation by the railroads.*—For many years prior to 1906 an association had existed known as the Association of American Railway Accounting Officers. This association included in its membership the accounting officer of the appellant company and the accounting officers of practically every steam railroad doing an interstate business in this country. After the adoption of the Hepburn amendment in 1906 this association, at its annual meeting in June of that year, created a special committee on corporate, fiscal, and general accounts, with a membership of 25 selected accountants. According to its records this committee was constituted "for the purpose of dealing with and directing matters incidental to the corporate, fiscal, and general accounts of railways, including the consideration of accounts and returns required by the National and State commissions." (Record, pp. 225 and 226.)

The appellant company had its accountant upon this committee.

*Submission of questions and plans for criticism.*—Mr. Adams, to avail himself of the expert knowledge of the members of this committee, entered

into correspondence and personal relations with the committee. Circular letters suggesting various questions of a general and specific nature were issued from time to time to the committee and distributed among the members for study; tentative plans were also sent to the executives of the railroads, with a request for criticism and suggestion, before adoption. The first circular, No. 1, dated September 10, 1906, is found on pages 228 and 229, volume 2 of the record, and reflects the purpose and method of investigation adopted by the commission. This circular was followed at intervals by many others. A vast correspondence resulted. Discussions were had at the meetings of the committee of 25, at which Mr. Adams was present, and in which he took some part. In this way the commission secured a wide and extended knowledge of the practices of different carriers in the matter of classification of accounts; a knowledge of the differing business policies reflected in existing accounts, and the objections and evils inherent in certain practices and forms of accounting. This information was reported by Mr. Adams to the commission, and was fully discussed by the commission in reference to the subject of classification, bookkeeping, etc., and its relation to the purposes which Congress and the commission had in view.

*Evils to be avoided.*—It was found that there were two evils existing in railway accounting which, in view of the public interests, required attention.

These accounting evils reflected the business policy of two classes of roads, and may be stated generally as follows:

1. The more prosperous roads were charging into operating expense large sums of money expended for betterments; these sums should have been charged to the property account. The object in making these charges to operating expense was to justify and maintain high rates by keeping the balance of *net* revenue as low as possible, thereby creating the impression that the roads were not earning any more at the rates charged than they ought to earn. By this method of classification the public was paying rates that were so high that it enabled the railroad companies to pay interest upon bonds, dividends upon stocks, and at the same time make very substantial additions to their properties. It needs no argument to show that this was unfair to the public.

2. The poorer roads, *anxious to borrow money upon their assets*, were retaining in the property account large items representing property which had been worn out or abandoned. Switches, and parts of railroad, buildings, equipment, etc., which had proved to be unprofitable or useless, were still represented by their cost in the property account; thus creating a false statement of existing assets.

*A true balance.*—The commission desired to make the accounts show every transaction and the true cost of every railroad *as operated* at any given time. The property account, like a bank account, should represent the additions and withdrawals.

Such accounting gives a full and complete record of every transaction, whether it be an addition and betterment or whether it represents the withdrawal of the cost of abandoned property. The balance of such an account should at any given time show the true cost of the property *then existing*; not the value of something that has existed in the past, but the value of the *property existing and in use* at the time the balance is struck. To omit charges that should be made to this account, by charging the items to operating expenses, or to fail to credit the account with the value of property retired and abandoned, destroys the integrity of the property account.

*Encouraging improvements.*—Another important matter for consideration was the encouragement of all sound plans for the improvement and betterment of the railroads. The public is interested in having good and efficient transportation facilities.

Improvements are, therefore, for the benefit of the public, and the public should encourage the making of<sup>2</sup> needed improvements. By treating the net cost of abandoned property as depreciation and putting it into the operating-expense account the net revenues of the company are thereby decreased, and this fact, as above noted, tends to prevent the forced reduction of rates until the losses have been earned at prevailing rates. This gives the public immediate benefit of improved service. When the losses have been paid off, and the net revenue is thereby increased, the public may then receive an additional

benefit in the reduction of rates based upon a lessened cost of service occasioned by the improvements.

*The regulation.*—The commission, after nearly three years of very careful investigation and study, adopted and promulgated a uniform classification of accounts and a balance sheet for all rail carriers. These are in force, *without objection*, on over 230,000 miles of railroad, and all statistical reports, since their adoption, are based upon them.

*Excerpts from rules:*

#### GENERAL INSTRUCTIONS.

1. APPLICATION OF THIS CLASSIFICATION.—This classification should be so applied as to reflect the net increase or decrease (determined according to the rules provided) in the investment of a carrier in such property as is used in the operation of railways as transportation agencies, including outside operations incidental to furnishing transportation. Entries in the accounts prescribed in this classification should be made only with respect to additions to, betterments of, and withdrawals and retirements of property composing the plant and equipment of existing main and branch lines, including sidings and spur tracks and the necessary buildings, structures, and facilities. \* \* \*

2. INCLUSION OF ALL ADDITIONS, BETTERMENTS, AND DEDUCTIONS.—The accounts herein provided should include the cost of additional land, buildings, structures, and facilities not taking the place of any property of like purpose previously held by the accounting

carrier; the cost of newly acquired equipment; the cost of improving land, buildings, structures, facilities, and equipment by additions thereto not involving the replacement of the property improved; the excess cost of improved buildings, structures, or facilities (except land and equipment) over the cost of replacing in kind structures and facilities of like purpose demolished, abandoned, or withdrawn from service; and the necessary credits to represent property abandoned, sold, or otherwise retired from service.

\* \* \* \* \*

#### I. PROPERTY RETIRED AND REPLACED.

When property (other than land or equipment), a betterment of which would be chargeable to the accounts of this classification, is abandoned, demolished, or otherwise retired from service for the purpose of or by reason of its replacement by property of like purpose of a better kind or a higher type, the cost of replacing in kind the property so abandoned or withdrawn from service, less the salvage, if any, should be charged to operating expenses. If, however, a reserve for abandonment, as provided in paragraph 8 of these instructions, or a reserve for accrued depreciation has been created with respect to such property, the reserve account should be first debited with an amount equal to the credits thereto made with respect to the property abandoned or withdrawn and replaced; but if no reserve has been created in advance of the retirement of such property and the amount chargeable to operating expenses is relatively

large, so much of the amount as may be authorized under the conditions outlined in paragraph 9 may be carried in suspense for distribution to the operating expenses of succeeding years.

A 5. GRADE REDUCTIONS AND CHANGES OF LINE. To this account should be charged:

\* \* \* \* \*

For changes of line (construction of new lines for the purpose of improving grade or alignment): The difference between the cost of the new line and the cost of replacing in kind the line abandoned, excluding the cost of right of way for both lines, but including the cost of engineering, clearing, grubbing, and grading; tunnels, bridges, trestles, and culverts; ties, rails, frogs, and switches; track fastenings and appurtenances; ballasting, tracklaying, and surfacing; fencing right of way; crossings and signs; interlocking and signal apparatus; telegraph and telephone lines; also cost of tools, rent and cost of operation of steam shovels, other work equipment, locomotives, and cars, and pay of crews employed in the work.

A 23. SHOPS, ENGINE HOUSES, AND TURN-TABLES. To this account should be charged the cost of additional shops, engine houses, and turntables, and of additional fixtures, facilities, and appurtenances (other than shop machinery and tools) necessary to equip them; also the excess cost of new buildings or structures or parts of buildings or structures, and new fixtures, facilities, and appurtenances over the cost of replacing in kind like property removed.

*Appellant's special complaints.* 1. In addition to the general theory of accounting advanced by the petitioner, which will be hereafter noted in the argument, the petitioner claims that the classification and bookkeeping prescribed by the commission requires the company to make "false entries" and "untruthful statements" to its stockholders. This is based upon the allegations that the stockholders of the Kansas City Southern authorized the directors to borrow money upon bonds, secured by mortgage upon its property, and appropriated \$1,200,000 to the work of reducing the grades under consideration to five-tenths of 1 per cent. Part of this money has been used in making the changes at six points on their railroad, costing nearly \$630,000; and it is alleged the whole of this expenditure can not be represented in the property account. The cause of this is that certain sections of the old line were abandoned, and under the orders of the commission the estimated cost, less salvage, of these abandoned portions must be deducted from the cost of the improvement, and only the balance can be charged to the property account. The counsel for the petitioner speak of this as a "loss" or a "destruction of property" or property rights, and, therefore, they say the order is unreasonable and in violation of the fifth amendment to the Constitution. They also claim that the company has the right to determine what these public accounts shall show, it being, they claim, a matter of business policy not under the control of Congress or the commission.



2. It is also claimed by the petitioner that to charge the cost of the abandoned strips, less salvage, to the operating expense account will prevent the payment of dividends upon its preferred stock. This, we admit, may be true if the entire sum is charged to the operating expenses of 1912. This year is exceptional, however, and can not affect the validity of the rule which is intended for general application.

It must be presumed that the stockholders and directors acted under and in view of the law and took into account, as a matter of business policy, the advantages of having the improvements over the disadvantage of temporarily passing a part of its dividends. The matter, however, can be easily arranged so as not to produce the result named by applying to the commission and having the total charge for abandoned property distributed over a series of years; the dividend upon preferred stock could then be paid.

A map showing the six changes in the line and the abandoned strips is presented for the inspection of the court upon the oral argument.

#### QUESTIONS OF LAW

##### I.

**Has Congress the power to classify the receipts and expenditures of common carriers subject to the act to regulate commerce, and require that all carriers shall have a uniform system of accounts, and that they shall make annual reports with a uniform balance sheet?**

*Power of Congress over interstate commerce.*—The power of Congress is fixed by two clauses in the Federal Constitution, article I, section 8, paragraphs 3 and 18. Summarized, Congress has power to “reg-

ulate" interstate and foreign commerce and make all laws necessary and proper to carry into effect the power to regulate.

Mr. Chief Justice Marshall, in *Gibbon v. Ogden* (9 Wheaton, 1, 196), stated this power as follows:

It is the power to regulate; that is, to prescribe the rule by which commerce is to be governed. This power, like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed in the Constitution.

This definition has been accepted by this court without deviation since it was uttered. It has been elaborated and applied to many varying cases; and in all cases the power of Congress over interstate and foreign commerce has been declared to be plenary, with all the incidents of sovereignty that attend the manifestation and exercise and application of this power.

In the *Lottery case* this court, speaking through Mr. Justice Harlan, said:

\* \* \* the power to regulate commerce among the several States is vested in Congress *as absolutely as it would be in a single government*, having in its constitution the same restrictions on the exercise of the power as are found in the Constitution of the United States; that such power is *plenary, complete in itself*, and may be exerted by Congress *to its utmost extent*, subject *only* to such limitations as the Constitution imposes upon the exercise of the

power granted by it; and that in determining the character of the regulations to be adopted Congress has a large discretion which is not to be controlled by the courts, simply because, in their opinion, such regulations may not be the best or most effective that could be employed. (188 U. S., p. 353.)

In *Hoke et al. v. United States* (227 U. S., 308), recently decided, this court, construing the act commonly known as the white slave act, speaking through Mr. Justice McKenna, said:

The principle established by the cases is the simple one, when rid of confusing and distracting considerations, that Congress has power over transportation "among the several States"; that the power is complete in itself, and that Congress, as an incident to it, may adopt not only means necessary but convenient to its exercise. \* \* \* The power is direct; there is no word of limitation in it, and its broad and universal scope has been so often declared as to make repetition unnecessary. \* \* \* How far-reaching are the powers and the means which may be used to secure its complete exercise we have expressed in *Hipolite Egg Co. v. United States* (220 U. S., 45).

In regulating interstate commerce Congress has plenary power over the agents conducting such commerce. (*The Daniel Ball case*, 77 U. S., 557, 566; *Employers' Liability cases*, 207 U. S., 497; *Second Employers' Liability cases*, 223 U. S., 4; *I. C. C. v. Goodrich Transit Co.*, 225 U. S., 194, 205.)

The only condition attaching to the exercise of this power is stated by this court, speaking through Mr. Justice Harlan, as follows:

Manifestly, any rule prescribed for the conduct of interstate commerce, in order to be within the competency of Congress under its power to regulate commerce among the States, must have some real or substantial relation to or connection with the commerce regulated. (*Adair v. United States*, 208 U. S., 178.)

*Forms of accounts and reports have a substantial relation to the regulation of commerce.* The original cost of a railroad, and its cost kept accurately up to date by proper charges and withdrawals from its property account, have a real and substantial relation to, and connection with, the *cost* of the transportation regulated. The need of this information is constant and vital in the regulation of railroad rates, and must be considered by Congress and by the commission. This court, speaking through Mr. Justice Harlan, said:

What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. \* \* \*

*The original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and*

stock, *the present as compared with the original cost of construction*, the probable earning capacity of the property under particular rates prescribed by statute, and *the sum required to meet operating expenses are all matters for consideration*, and are to be given such weight as may be just and right in each case. (*Smyth v. Ames*, 169 U. S., 466, 541, 544, 547.)

In the *Goodrich case*, *supra*, the court said (p. 215):

\* \* \* Bookkeeping, it is said, is not interstate commerce (p. 216). True, it is not. But bookkeeping may and ought to show how a business which, in part at least, is interstate commerce, is carried on, in order that the commission, charged with the duty of making reasonable rates and prohibiting unfair and unreasonable ones, may know the nature and extent of the business of the corporation, the cost of its interstate transactions, and otherwise to inform itself so as to enable it to properly regulate the matters which are within its authority.

*Public records, exclusively under public control.*—

The public records of railway statistics kept by the Interstate Commerce Commission for the information of the Government are necessarily subject to Government direction and control. Congress has power to say what these records shall contain, what facts shall appear, and how these facts shall be classified for public use. In the twentieth section above quoted Congress expressly specified the facts which it desires to have appear in the annual reports of the carriers. Among these items so specified are the

cost and value of the railroad and the cost of its operation. The commission is given power to ask for any other information necessary or desirable in order to carry out the purposes of the act. This legislation by Congress is not unusual or extraordinary in any sense.

The necessity of such accounts is emphasized under the English practice, and accounts and reports are required in great detail under the laws of that country.

In the report of the committee appointed by the board of trade under the railway regulation acts to make inquiries with respect to the form and scope of the accounts and statistical returns rendered by railway companies the omission of the former law to make provision for any prescribed and uniform system of accounts is pointed out, and it is said:

"It is obviously of the first importance, from the point of view of comparison between the different railway companies, that there should be uniformity of practice among all the companies with regard to the keeping of accounts and statistics; that is to say, that every heading, both in the accounts and in the statistics, should bear precisely the same meaning in the case of all railways—should, in effect, be standardized.

"The Railway Companies (accounts and returns) act, December 16, 1911, 1 and 2 Geo. 5, c. 34, to amend the law with respect to accounts and returns of railway companies contains requirements as to financial accounts and statistical returns which call for a uni-

form system of accounting, showing the organization and workings of the companies in great detail, together with statistical returns as to their business, subdivided so as to include all the operations of the companies as carriers and in all other enterprises in which they may engage." (*L. C. C. v. Goodrich Transit Co.*, *supra*, p. 212.)

In this matter Congress can not be controlled by the particular policy of any railroad company. Certainly it can not be restricted in its endeavor to make these public accounts truthful in every respect and free from any accounting method that will inflate the assets of a company and tend to deceive the public and Congress. Keeping the value of wreckage in the property account is a vicious practice, and the failure to charge to operating expenses all items of depreciation is condemned by all good accounting and by the practices of the best managed railroads in this country.

## II.

Has Congress power to vest in the Interstate Commerce Commission, in the manner set forth in section 20 of the act, authority to determine the classification, and forms of accounts to be kept by the carriers, and the form of balance sheet to be returned annually to the commission by the carriers?

*Accounts and balance sheet.*—Accounts are the statements of debits and credits, of receipts and expenditures, of fiscal facts in, or pertaining to, the conduct of a business. The classification of these accounts consists in arranging and grouping into classes sundry items, each class constituting a general group of re-

lated matters. Bookkeeping is the record of these accounts arranged under prescribed classification, and a balance sheet shows the balances of these accounts, and the state or condition of the business at a given time. One of the objects of classification is to give a balance that will at any time correctly show the assets, the net amount received or expended, and the difference between receipts and expenditures in a specified group. Classification is extended as far in a particular business as the regulating power determines it to be necessary in order to give an intelligent and correct knowledge of the assets, the operating revenues, and operating expenses of the business.

*Classification made by Congress.*—Congress, by the provisions of section 20 heretofore quoted, in general terms specified the subjects upon which it desired to have information. It directs the carriers to furnish specific information upon these general topics. This constitutes in a general way a classification of accounts. To make this classification accurate and uniform, for comparison and other purposes, the commission is authorized to make more specific and detailed specification of the general classification and to see to it that the grouping of items under each general head will result in giving a truthful statement in each account and in the annual balance sheet. The policy of the railroad carrier is not controlling in this matter. There is no attempt to control the company in making reports to its stockholders, or in making statements to its fiscal agents. It may report and state its ac-



counts to them as it pleases and may state what it pleases. This regulation controls only the public accounts, which are kept pursuant to the act of Congress. This classification is in the interest of the public; to secure, so far as possible, a scientific distribution of receipts and expenditures under appropriate heads in order that Congress and the commission may have reliable and accurate knowledge of the property put to the public use and the operating revenues and expenses of the carriers.

The law also provides that examiners may be appointed and sent to examine the accounts of carriers. In order to do this efficiently and promptly, a uniform system of accounting by all carriers is necessary. The accounts of each carrier are to be classified so as to be comparable with the accounts of other carriers for legislative reasons and purposes. To make them comparable, they must be kept under a uniform system of classification and entries.

*Commission's order an extension of congressional action.* The work of the commission in preparing a detailed classification is only an extension of the congressional action. The whole must be considered as one fabric. Congress outlined the general plan and left the details to be formulated by the agency it had created for that purpose.

In *Buttfield v. Stranahan* (192 U. S., 470) this precise question was involved. The act under consideration in that case was to prevent the importation of unwholesome tea. A board of tea ex-

perts was to be appointed by the Secretary of the Treasury. Upon the recommendation of the board the Secretary of the Treasury was authorized to "fix and establish uniform standards of purity, quality, and fitness for consumption for all kinds of teas imported into the United States." Discussing the claim that "the statute commits to the arbitrary discretion of the Secretary of the Treasury the determination of what teas may be imported, and therefore in effect vests that official with legislative power," the court held that this claim was "without merit," and said:

We are of opinion that the statute, when properly construed, as said by the Circuit Court of Appeals, but expresses the purpose to exclude the lowest grades of tea, whether demonstrable of inferior purity or unfit for consumption. \* \* \* This, in effect, was the fixing of a primary standard, and devolved upon the Secretary of the Treasury the mere executive duty to effectuate the legislative policy declared in the statute. The case is within the principle of *Field v. Clark* (143 U. S., 649), where it was decided that the third section of the tariff act of October 1, 1890, was not repugnant to the Constitution as conferring legislative and treaty-making power on the President, because it authorized him to suspend the provisions of the act relating to the free introduction of sugar, molasses, coffee, tea, and hides. We may say of the legislation in this case, as was said of the legislation considered in *Field v. Clark*, that it

does not, in any real sense, invest administrative officials with the power of legislation. Congress legislated on the subject as far as was reasonably practicable, and from the necessities of the case was compelled to leave to executive officials the duty of bringing about the result pointed out by the statute. To deny the power of Congress to delegate such a duty would, in effect, amount but to declaring that the plenary power vested in Congress to regulate foreign commerce could not be efficaciously exerted.

The court cited approvingly the following:

The true distinction is between the delegation of power to make the law, which necessarily involves a discretion as to what it shall be, and conferring authority or discretion as to its execution, to be exercised under and in pursuance of the law. The first can not be done; to the latter no valid objection can be made. (*Field v. Clark*, 143 U. S., 649.)

In *United States v. Grimaud* (220 U. S., 506, 515, 516, 517) Mr. Justice Lamar, speaking for the court, said:

From the various acts relating to the establishment and management of forest reservations it appears that they were intended to improve and protect the forests and to secure favorable conditions of water flows.

It was declared that the act should not be "construed to prohibit the egress and ingress of actual settlers" residing therein nor "to prohibit any person from entering the reservation for all proper and lawful purposes,

including that of prospecting and locating and developing mineral resources, provided that such person comply with the rules and regulations covering such forest reservation." \* \* \*

It was also declared that the Secretary "may make such rules and regulations and establish such service as will insure the objects of such reservations, namely, to regulate their occupancy and use and to preserve the forests thereon from destruction; and any violation of the provisions of this act or such rules and regulations shall be punished \* \* \*."

Referring to the necessity for regulations consistent with varying conditions, the court said:

In the nature of things it was impracticable for Congress to provide general regulations for these various and varying details of management. Each reservation had its peculiar and special features; and in authorizing the Secretary of Agriculture to meet these local conditions Congress was merely conferring administrative functions upon an agent and not delegating to him legislative power. The authority actually given was much less than what has been granted to municipalities by virtue of which they make by-laws, ordinances, and regulations for the government of towns and cities. Such ordinances do not declare general rules with reference to the rights of persons and property, nor do they create or regulate obligations and liabilities, nor declare what shall be crimes nor fix penalties therefor.

By whatever name they are called they refer to matters of local management and local police. \* \* \* They are "not of legislative character in the highest sense of the term; and as an owner may delegate to his principal agent the right to employ subordinates, giving them a limited discretion, so it would seem that Congress might rightfully intrust to the local legislature [authorities] the determination of minor matters." (*Butte City Water Co. v. Baker*, 196 U. S., 126.)

It must be admitted that it is difficult to define the line which separates legislative power to make laws from administrative authority to make regulations. This difficulty has often been recognized, and was referred to by Chief Justice Marshall, in *Wayman v. Southard* (10 Wheat., 142), where he was considering the authority of Congress to make rules. He there said:

"It will not be contended that Congress can delegate to the courts, or to any other tribunals, powers which are strictly and exclusively legislative. But Congress may certainly delegate to others powers which the legislature may rightfully exercise itself." What were these nonlegislative powers which Congress *could* exercise but which might also be delegated to others was not determined, for he said: "The line has not been exactly drawn which separates those important subjects, *which must* be entirely regulated by the legislature itself, from those of less interest, in which a general provision may be made, and power given to those who are to act under such general provisions to fill up the details."

From the beginning of the Government various acts have been passed conferring upon executive officers power to make rules and regulations—not for the government of their departments, *but for administering the laws which did govern*. None of these statutes could confer legislative power. But when Congress had legislated and indicated its will, it could give to those who were to act under such general provisions “power to fill up the details” by the establishment of administrative rules and regulations, the violation of which could be punished by fine or imprisonment fixed by Congress, or by penalties fixed by Congress or measured by the injury done.

In *Light v. United States* (220 U. S., 523), the opinion by Mr. Justice Lamar, *United States v. Grimaud* was followed upon the point above quoted.

In *I. C. C. v. Goodrich Transit Co.*, *supra*, Mr. Justice Day, speaking in reference to the provisions of section 20, said (p. 209):

The commission is vested with authority to prescribe the manner in which such reports shall be made and to require specific answers to all questions as to which the commission may need information \* \* \* (p. 210).

As to the accounts, the statute permits the commission, in its discretion, for the purpose of enabling it the better to carry out the purposes of the act, to prescribe a period of time within which such common carriers shall have a uniform system of accounts and the manner in which such accounts shall be kept. The commission may, the statute further provides,

in its discretion, prescribe the forms of all accounts, records, and memoranda to be kept by the common carriers, to which accounts the commission shall have access. And the act makes it unlawful for the carriers to keep any accounts, records, or memoranda other than those prescribed by the commission.

*We think this section contains ample authority for the commission to require a system of accounting as provided in its orders and report in the form shown to have been required by the order of the commission \* \* \* (p. 211).*

Referring to the commission's duty to enforce the act and make reports to Congress requiring a knowledge of the business of the carrier, the court further said:

If the commission is to successfully perform its duties in respect to reasonable rates, undue discriminations, and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. \* \* \* The necessity of keeping such accounts has been developed in the reports of the commission and has been the subject of great consideration. It caused the employment of those skilled in such matters, and has resulted in the adoption of a general form of accounting which will enable the commission to examine into the affairs of the corporations, with a view to discharging its duties of regulation concerning them. \* \* \* We think

the act should be given a practical construction, and one which will enable the commission to perform the duties required of it by Congress \* \* \* (p. 214).

Furthermore, it is said that such construction of section 20 makes it an unlawful delegation of legislative power to the commission. We can not agree to this contention. The Congress may not delegate its purely legislative power to a commission, but having laid down the general rules of action under which a commission shall proceed, it may require of that commission the application of such rules to particular situations and the investigation of facts, with a view to making orders in a particular matter within the rules laid down by the Congress. This rule has been frequently stated and illustrated in recent cases in this court and needs no amplification here. (Citing *Buttfield v. Stranahan*, *supra*; *Union Bridge Co. v. United States*, 204 U. S., 384; *United States v. Grimaud*, *supra*.)

In section 20 Congress has authorized the commission to require annual reports. The act itself prescribes in detail what those reports shall contain. The commission is permitted, in its discretion, to require a uniform system of accounting and to prohibit other methods of accounting than those which the commission may prescribe. In other words, Congress has laid down general rules for the guidance of the commission, leaving to it merely the carrying out of details in the exercise of the powers so conferred. This, we think, is not a delegation of legislative authority.



The Goodrich case seems to be absolutely conclusive of this case. In view of all the authorities we submit that the act conferring upon the commission power to prescribe a classification and uniform system of accounts is not a delegation of legislative authority.

### III.

Did the commission, in making the general orders complained of, conform to the requirements of the law?

*In prescribing the classification of accounts, book-keeping, and an annual balance sheet the commission was acting in purely a legislative capacity.* The act did not require that any hearing be given to the carriers. Like Congress, the commission was to inform itself upon the subject, and in pursuance of the general instructions of Congress contained in the act, was authorized to prescribe a uniform classification and system of accounts for all interstate carriers. The commission was to fill in the details, and this involved a classification of the items going into the accounts. The proceedings by the commission fall within the general category of administrative functions specifically referred to in *Buttfield v. Stranahan* (192 U. S., 470, 496, 497), wherein Mr. Justice White, now Chief Justice, speaking for the court, and referring to the case of *Field v. Clark* (143 U. S., 649), said:

Waiving the point that the plaintiff in error does not appear to have asked for a hearing, and assuming that the statute did not confer

such a right, we are of opinion that the statute was not objectionable for that reason. The provisions in respect to the fixing of standards and the examination of samples by Government experts were for the purpose of determining whether the conditions existed which conferred the right to import, and they therefore in no just sense concern a taking of property. This latter question was intended by Congress to be finally settled, not by a judicial proceeding, but by the action of the agents of the Government, upon whom power on the subject was conferred.

In *Interstate Commerce Commission et al. v. Goodrich Transit Co.* (224 U. S., 194, 205) the order of the commission under consideration was issued under section 20; the order was general and issued without any formal hearing. Mr. Justice Day, speaking for the court, said:

It is averred that the bookkeeping and accounting methods required by the orders of the commission differ from those prescribed and now kept by the companies; \* \* \* and that the orders entered by the commission prohibit the companies from keeping any accounts, records, or memoranda other than those prescribed by the commission in such orders. \* \* \*

\* \* \* We think the uniform system of accounting prescribed and the report called for are such as it is within the power of the commission to require under section 20 of the act.

In *Prentiss v. Atlantic Coast Line* (211 U. S., 210, 226, 227), Mr. Justice Holmes, speaking for the

court and distinguishing between legislative and judicial acts, said:

A judicial inquiry investigates, declares, and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation, on the other hand, looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power. \* \* \* That question depends not upon the character of the body, but upon the character of the proceedings, \* \* \* and it does not matter what inquiries may have been made as a preliminary to the legislative act. Most legislation is preceded by hearings and investigations. But the effect of the inquiry and the decisions upon it is determined by the nature of the act to which the inquiry and decision lead up. \* \* \* The nature of the final act determines the nature of the previous inquiry. \* \* \* So, when the final act is legislative, the decision which induces it can not be judicial in the practical sense, although the questions considered might be the same that would arise in the trial of a case. \* \* \*

The proceedings of the commission being in their nature legislative, are not governed by some of the rules applicable to a judicial or *quasi-judicial* inquiry. A *quasi-judicial* inquiry occurs where there are before the tribunal *in fact* a complainant and a defendant; a party who seeks, or is to be given, relief against a party who has the power and duty to give,

but refuses to grant the right asked for. The tribunal that decides such issues is either judicial or *quasi judicial*. In the case at bar the proceedings by the commission leading up to the promulgation of the order providing for classification, etc., are purely administrative and the conclusions can not be reviewed except for the purpose of determining questions of law applicable to action by administrative officers, acting under constitutional statutes directing them to bring "about the result pointed out by the statute," and authorizing them to make rules and regulations necessary to carry out the general provisions of the statute. The commission, therefore, as shown by the facts in this case, acted with full power and in conformity with the law.

#### IV.

**Did the Commission act in an unreasonable or arbitrary way in requiring the carriers, when making improvements and betterments chargeable to property account, to deduct from the cost of these improvements and charge to operating expense account, the cost or estimated cost, less salvage, of the property abandoned?**

*The cost of the road as operated.*—One of the specific requirements of section 20 is that the annual report shall state the cost of the railroad. As we have already observed, this is an *annual* report, and is made to show the conditions existing *at the time the report is made*. It is not to be the cost of a railroad which the carrier operated in some former year, but it is to be the cost of the railroad operated by the carrier during the year covered by

the report, the cost of the physical structure then operated which can be inventoried. Wreckage and abandoned property no longer in use (whether switches, line road, shops, or equipment) can not be inventoried for valuation. To pad the accounts and reports by retaining the cost of such wreckage would deceive the Commission and Congress. There should be no question in the mind of any unprejudiced observer that the cost of property no longer in use has no place in the "balance" of the property account.

*Charge to operating expense to encourage proper improvements.*—How to dispose of this charge equitably to the owners and the public in a way not to discourage the making of necessary improvements was one of the questions before the Commission. It solved it by saying, in effect, that if the proposed improvement of the road was for future use—that is to say, was to meet future demands upon the carrier for improved service—the cost should be charged to operating expenses. The effect of this is to increase the operating-expense account for the year, or for a period of years over which the charge may be spread, and thereby maintain existing rates and enable the carrier to pay for such abandonments out of its operating revenues. The cost or value of the abandonment having been deducted from the cost of the new improvements and the balance only being charged to property account, the revenues are not charged with the cost of betterments. It is an

equitable distribution of the burden between the carrier and the public; a distribution justified by the interests of both the public and the carrier, and it will encourage all proper improvements of railway property and service.

An improvement like the one under consideration will, it is alleged, reduce the cost of the service; if it does, it might lead the public to expect a reduction in rates; but the charge of the cost of the abandoned property (less salvage) into operating expense tends to justify the maintenance of existing rates until that loss has been paid for.

*Application of borrowed money.* Counsel for the petitioner claim that as these improvements were paid for out of borrowed money it would be an "untruthful record" if the property account was not increased by an amount equal to the expenditure. It is not claimed, and can not be claimed, that the accounting prevents the proper application of the borrowed money to the purposes for which it was appropriated. There is nothing in the mortgage or in any of the negotiations leading up to the borrowing of the money that attempts to direct the bookkeeping accounts of the expenditures.

We must assume that the action of stockholders and directors was taken subject to the regulating power of Congress. No action or dictation by the stockholders, or any of the officers of the company, can curtail or affect the regulating power of Congress. The records required by the commission give a full and clear account of this expenditure.

*Charge to operating expense does not affect the cash account.*—The charging of the amount of the cost or replacement value of the abandoned property to operating expenses does not require the payment of any money, and therefore does not decrease the amount of cash on hand. This is explained in the testimony of Mr. Adams. (Vol. 2, pp. 417, 419.)

The two different methods, that provided by the rule and the one insisted upon by the appellant, is illustrated by the following arbitrary statements. Account A is made in accordance with the appellant's theory, and account B in accordance with the commission's order. The balances used are the actual balances shown in the last report of the Kansas City Southern. For the cost of the grade reductions the sum of \$600,000 is used, and for the cost of abandoned property the sum of \$400,000 is used. The actual amount, in each case, is a little more.

## (A) APPELLANT'S THEORY.

## PROPERTY ACCOUNT.

Real and equipment June 30, 1909, .....	\$73,072,304.79
Add expenditures for grade reduction, .....	600,000.00
Other additions to property account, .....	1,042,223.50
Total June 30, 1910, .....	74,714,528.29

## INCOME ACCOUNT.

Operating revenues year ending June 30, 1910, .....	\$9,591,651.58
Operating expenses year ending June 30, 1910, .....	6,268,584.67
Net operating revenues, .....	3,323,066.91
Charges to net revenues, including dividends, .....	2,674,645.92
Balance for year carried to profit and loss, .....	651,420.99

## CASH ACCOUNT.

Cash on hand June 30, 1909:	
From sale of bonds for grade reduction.	\$1, 200, 000. 00
Other cash.....	364, 348. 76
	<u>\$1, 564, 348. 76</u>
Less amount expended for grade reductions during the year, as per stockholders' resolution.....	600, 000. 00
	<u>964, 348. 76</u>
Net additions during 1910 from operation and other sources	1, 595, 965. 23
Cash on hand June 30, 1910.....	<u>2, 560, 343. 99</u>

## (B) COMMISSION'S SYSTEM.

## PROPERTY ACCOUNT.

Road and equipment June 30, 1909.....	\$73, 072, 304. 79
Betterments made and paid for in year ending June 30, 1910.....	\$600, 000. 00
Less estimated value of property abandoned and replaced.....	400, 000. 00
	<u>200, 000. 00</u>
Other additions during the year.....	<u>1, 042, 223. 50</u>
Total June 30, 1910.....	<u>74, 314, 528. 29</u>

## INCOME ACCOUNT.

Operating revenues year ending June 30, 1910.....	\$9, 594, 651. 58
Operating expenses (ordinary) year ending June 30, 1910.....	\$6, 268, 584. 67
Operating expenses chargeable on account of abandoned lines.....	400, 000. 00
	<u>6, 668, 584. 67</u>
Total operating expenses.....	<u>2, 926, 069. 91</u>
Net operating revenues.....	<u>2, 674, 645. 92</u>
Charges (net) to net revenues, including dividends.....	<u>251, 420. 99</u>
Balance for year carried to profit and loss.....	

## CASH ACCOUNT.

Cash on hand June 30, 1909:	
From sale of bonds for grade reduction.	\$1, 200, 000. 00
Other cash.....	364, 348. 76
	<u>1, 564, 348. 76</u>
Less amount expended for grade reductions during the year as per stockholders' resolution.	600, 000. 00
	<u>964, 348. 76</u>



Net additions during 1910 from operation and other sources, .....	\$1,595,995.23
Total.....	2,569,343.99
Analysis cash on hand June 30, 1910:	
Balance from sale of bonds, .....	\$600,000.00
Revenue withheld from surplus on ac- count of abandoned property charged to operating expenses, .....	400,000.00
Other cash, .....	1,569,343.99
	2,569,343.99

*No destruction of property.*—There is no misstate-  
ment in account B of the use of the funds bor-  
rowed; they are applied to the precise purpose for  
which they were borrowed. While the property  
account does not show an advance of six hundred  
thousand odd dollars, it does show an increase of  
\$200,000, and the cash account has in it the item  
of \$400,000 reserved from revenue, and applicable  
to future improvements, or, if they chose to put  
it that way, there is \$400,000 of the borrowed money  
still remaining. The cash account is drawn upon  
without specifying the source of the cash drawn and  
is the same under either theory. The operating ex-  
pense account is not a cash account, and a charge to  
operating expense, not requiring the payment of  
cash only reduces the *net revenue applicable to divi-  
dends*; it does not in any way dissipate the cash on  
hand. (Rec., vol. 2, pp. 417, 419.)

*Does not affect the administration of the funds.*—Nor  
does this method of accounting in any way affect  
the proper administration of the funds set aside by  
the stockholders and directors for these improve-  
ments and referred to in the mortgage. The precise

language in the resolution is found on page 2 of the Record (vol. 1), item 2 of the petition:

To reduce grades to one-half of 1 per cent on three full operating divisions aggregating 41 per cent of the total length of the line, \$1,250,000.

Nothing is said in this resolution about having the property account show the full investment, and so with the mortgage. The reference in the mortgage reads as follows (Rec., vol. 1, p. 3):

The railway company covenants to use the bonds so delivered to it and the proceeds thereof in calling in and redeeming and canceling its five million one hundred thousand (\$5,100,000) collateral gold notes issued April 2, 1906, *and for the general improvement of its property.* (See also provisions, Rec., vol. 2, p. 10.)

There is no provision in the mortgage directing how the accounts shall be kept or that the cost of the improvements shall appear, to the full extent of the amount expended, in the property account. The railroad company, its fiscal agents, and the purchasers of the bonds are charged with notice of the requirements of the law regarding the keeping of these accounts; and it must be assumed, there being nothing in the record to the contrary, that it was understood that the accounts would be kept in accordance with the law.

But, however this is viewed, the accounts state the transaction according to the best theories of

accounting and give a correct history of the transaction and show accurately the loss and the true cost balance of the actual property on hand used for railroad purposes. There is, as already noted, no destruction of property in deducting the cost of the abandonments from the property account. The abandonment is a loss and the accounts should show it. But the true account of existing assets is represented in the property account and the cash account.

### V.

Is the requirement that the cost or estimated value, less salvage, of abandoned property be charged to the operating expense account a violation of any right guaranteed to the appellant by the Constitution of the United States?

Having determined that this item of abandoned property should be taken from the property account, the question arises where should it be charged, whether, as required by the rules, to operating expense, or, as claimed by the appellant, to the profit and loss account?

*Abandonments not replaced in kind.*—As already noted, the rule of the Commission rests upon the theory that abandonment is "depreciation." Depreciation is of two kinds—(1) that depreciation which is not replaced in kind and (2) that which is replaced by improved materials, track, or equipment. Suppose, for instance, a trunk line has a branch from its station A to point B at right angles to the main line. Finding that this branch is not profitable, it is abandoned, the track is taken up and

is not replaced in kind—that is, the territory is not served by any new railroad. That line then ceases to be an earning instrumentality. Nothing will accrue to the stockholders in the future because of it. It has served its purpose and only past operations have benefited from it. The results of the past operations, not distributed to the stockholders, are represented in the profit and loss account. Therefore this abandonment or depreciation is chargeable to the accumulated profits which have been earned during the period of its operation.

*Abandonments replaced in kind.*—The other kind of depreciation is represented in changes resulting from inadequacy of the existing property to supply future demands upon it. The road or the structures, therefore, have to be replaced with stronger or more efficient instrumentalities. The abandonments which are occasioned by these changes are therefore chargeable to future earnings, for the reason that the improved condition of the road is to meet the demands of the future, and its operation will be for the benefit of those who hold the stock of the company now and in the future. Therefore the operating expenses of the future must pay for this depreciation. The railroad company may, *if its policy so dictates*, anticipate general depreciations and make provisions for them by establishing a reserve for that purpose. If no such provision has been made, showing an intention to provide for future depreciation, these abandonments must be taken care of, so far as a compulsory rule is concerned, by charging

the depreciation to present or future operating expense.

*Improvements on original right of way.*—Counsel for the appellant profess to see some injustice in the fact that if these improvements had been made as first proposed upon the original right of way the "full amount of the cost" would appear in the property account.

If the improvements had been made on old right of way, they would clearly appear, could be inventoried and appraised. One of the witnesses, calling attention to this fact, made a diagram which is shown upon page 804, volume 1, of the record. This shows a cut to reduce a grade; "A" shows the old line and "B" the additional cut or improvement. If this work had been done when the original road was constructed, it would have added to the cost; the road would have been a more expensive road. So, after the new improvement is made it represents a more costly road and a better road; it will be inventoried and appraised at its present value; the substantial cost of the improvement, therefore, is chargeable to the property account. It is not true that there would be, in such a case, no abandonments that would be taken out of property account because all improvements involve abandonments of materials to a greater or less degree. These abandonments have to be taken out of the property account, the same as is done where parts of the roadbed are abandoned. The principle is the same in each case and works out absolute justice in both cases.

*Depreciation is an operating expense.*—As Congress has plenary power, it certainly can determine for itself and the public what shall be considered “depreciation,” to be charged to current revenues. But this rule rests upon the best experience and authority. In a recent edition of his able work, entitled “Auditing, Theory, and Practice” (1912), Mr. Robert H. Montgomery, an authority of high standing, deals with the subject of depreciation. He defines it and gives the various elements which constitute depreciation. On page 319 he quotes approvingly from Prof. M. E. Cooley, another eminent authority. Prof. Cooley gives four elements of depreciation—(1) that due to wear and tear and exposure to the elements, (2) that due to accidents or sudden depreciation, (3) that due to inadequacy, and (4) that due to obsolescence. The case at bar falls directly under the last two items. Prof. Cooley, in describing the *depreciation due to inadequacy*, says:

Cars suitable in the past had already been superseded several times by larger and better cars. This rendered the track, structure, and bridges inadequate, and, as more power is required to propel the larger cars, the power plants have become inadequate. The public demand is largely responsible for this depreciation due to inadequacy.

In describing obsolescence, he says:

This, while closely allied to the depreciation due to inadequacy, is different in that it embraces changes due to advance in the art.

More efficient and effective machinery has appeared, which must be substituted for the old to keep abreast of the times. For example, in steam-engine practice the turbine has come into general use during the past five years, and the art of steam turbines is at the beginning, etc.

The testimony in this case is clear and uncontradicted, that the changes in grade made by the petitioner were to meet *future demands* upon the railroad; to enable it to compete for *growing and increasing business*; to give to the public *in the future* better service, and thus build up and hold its traffic and thereby increase its revenues. (Rec., vol. 2, pp. 15, 18, 43.) This brings the case directly within the rule. It is sanctioned by the best authorities that abandonments caused by such improvements are the result of inadequacy and are, therefore, properly chargeable to the current revenues.

This theory was also adopted by the committee of 25 of the Association of American Railway Accountants at the meeting in Buffalo. (Bull. 28, Rec., vol. 2, pp. 133, 135.) This meeting was not a hasty one, nor was it in the meeting that the subject was thoroughly considered by the members. The question had been before them for many weeks, submitted by a circular letter, and the members had personally considered the matter. (Cir. No. 8, Rec., vol. 2, pp. 235, 238.) When the vote was taken they gave expression to their uninfluenced expert opinions, and a majority voted for the rule. It is true that

after the question had been submitted to the executives (Exhibit C, Rec., vol. 1, p. 135)—not expert accountants—and had been considered *from the standpoint of the executives*, the railroads divided, as they had divided before; the well-managed roads were in favor of the rule requiring the charge to be made to operating expenses and the weaker ones, seeking to borrow money upon overvalued assets, were against it. At the Atlantic City meeting, under the pressure of the executives, the result of the vote was changed, but a large minority still stood for the rule.

Expert accountants have testified in this case, and we “indent” *our abstract* of their testimony upon this point.

Mr. Robert I. Farrington, vice president and comptroller of the Great Northern Railway Company, testified (*references are to the pages of the record, vol. 2*):

The Commission's rule in controversy in this case is a reasonable rule (p. 292).

In my opinion the property account should not show the value of anything that has really been abandoned and is not now used. I think that the cost should be charged off to operating expenses, because, in my opinion, operating expenses not only includes the cost of carrying on the operation, but the wear and tear and general use of the property, some of which is tangible and can be covered by repairs and some of which you might call intangible and spread over a good many years and can not be charged currently but has to be provided for in some way or other, and as



depreciation it ought to be charged to expenses. Q. Would you include in depreciation losses caused by inadequacy of the line or inadequacy of the equipment to carry the traffic—to meet the demand upon it? A. I should cover that by depreciation; yes. Q. Would you cover by depreciation those losses which are occasioned by what is called obsolescence? A. Yes. Q. Would that apply to the track and railroad as well as to equipment? A. In my judgment; yes (p. 292).

I think the regulations are reasonable, and if the road is so unfortunately situated as to have to forego some dividends on account of compliance with these regulations, it does not change the reasonableness, because the regulations must cover all the roads and can not be made to cover any one particular unfortunate condition (p. 315).

Mr. W. E. Bailey, general auditor of the Atchison, Topeka & Santa Fe Railway Company, testified:

A railway plant deteriorates from abandonments the same way as it does from wear and tear and the action of the elements. Q. Would you include in the depreciation, in addition to wear and tear, sudden accidents? A. Yes, sir. Q. Would you include in depreciation as one of these causes inadequacy of equipment or road, or both? A. Yes, sir. Q. Will you state the reasons for your theory as an accountant for deducting or crediting to the property account the items of depreciation for the causes named? A. I think in railroad practice we should apply exactly the

same business rules as apply to any other business. Obsolescence is an expense and should be so treated (p. 320).

As an accountant I consider that all abandoned property should be written out of the capital account \* \* \* because it is a depreciation, and depreciation goes to the operating expenses (p. 322).

Prof. Henry C. Adams testified:

The reason for including in operating expenses a charge designed to wipe out of the accounts the property abandoned having been credited to the property account is that operating expenses may take care of the entire maintenance of the property, and this is regarded as the recognition of a form of depreciation (p. 353).

In view of this testimony, the action of the committee of twenty-five at the Buffalo meeting, and the position of the minority at the Atlantic City meeting (where the pressure of the executives was brought to bear), it can not be said that the reasonableness of the Commission's classification and order is not supported by substantial evidence, or that the order and classification, in the particulars mentioned, are unreasonable or arbitrary.

*Not a question of evidence.*—It is a question, however, whether the court in such a case as this should apply this test. In *Buttfield v. Stranahan*, where the regulations were made in pursuance of an act of Congress, as in this case, the test applied is stated as follows:

Whether or not the Secretary of the Treasury failed to carry into effect the express purpose of Congress and establish standards which operated to exclude teas which would have been entitled to admission had proper standards been adopted *is a question we are not called upon to consider.* The sufficiency of the standards adopted by the Secretary of the Treasury *was committed to his judgment, to be honestly exercised,* and if that were important there is no assertion here of *bad faith or malice* on the part of that officer in fixing the standards, or on the part of the defendant in the performance of the duties resting on him.

It is not a question of evidence, *it is a question of power; power of Congress to determine what its public records shall show; power to determine for the public what depreciation is, and where depreciation shall be charged* in the accounts of rail roads subject to the act; power to declare that the property account shall not be padded with wreckage.

It has been repeatedly held by this court that, even as to orders entered by the Commission when acting as a *quasi-judicial* body, *it is a question of power and not of expediency;* that if the Commission had power to make the order, and it acted within the statute and not arbitrarily or in bad faith *the courts will not review the Commission's conclusions of fact or substitute the judgment of the court for the judgment of the Commission.* If this be true of *quasi-judicial* orders, it must be preeminently true of orders to effectuate a law of Congress. This has been uniformly

held in reference to general orders made in pursuance of an act of Congress from the decision in *Field v. Clark*, *supra*, to that of the *Goodrich Transit Company*. To determine otherwise and in favor of the contentions of the petitioner would be to overthrow this whole line of decisions.

#### SOME FALLACIES IN APPELLANT'S BRIEF.

Reference is made to *Union Pacific R. R. Co. v. United States*, 99 U. S. 402, 434. In that case the Government was to receive 5 per cent upon the "net earnings." The question arose as to what charges could be made to operating expenses before striking the balance upon which the 5 per cent was to be computed. No question arose as to charging the cost of abandoned property to operating expenses. The only point in the opinion touching any part of this case is where the court disapproves of the practice of charging to operating expenses expenditures for permanent improvements. The court, speaking through Mr. Justice Bradley, said:

With regard to the last-mentioned class of expenditures, however, namely, those which are incurred in enlarging and improving the works, a difference of practice prevails amongst railroad companies. Some charge to construction account every item of expense and every part and portion of every item, which goes to make the road or any of its appurtenances or equipments better than they were before; whilst others charge to ordinary expense ac-

count, and against earnings, whatever is taken for these purposes from the earnings, and is not raised upon bonds or issues of stock. \* \* \* The temptation is to make expenses appear as small as possible, so as to have a large apparent surplus to divide. But it is not regarded as the wisest and most prudent method. The question is one of policy, which is usually left to the discretion of the directors. There is but little danger that any board will cause a very large or undue portion of their earnings to be absorbed in permanent improvements. The practice will only extend to those which may be required from time to time by the gradual increase of the company's traffic, the dispatch of business, the public accommodation, and the general permanency and completeness of the works. \* \* \* But for making all ordinary improvements, as well as repairs, it is better for the stockholders, and all those who are interested in the prosperity of the enterprise, that a portion of the earnings should be employed. We think that the true interest of the Government in this case is the same as that of the stockholders, and will be subserved by encouraging a liberal application of the earnings to the improvement of the works.

The court was not construing any legislative act determining this problem, but expressing the views of the court. It is both interesting and instructive to see that the court arrived at two conclusions which have governed the Commission: (1) That permanent improvements should not be charged to

operating expenses, but (2) that reasonable concessions might be made *for the purpose of encouraging improvements*.

In *Illinois Central R. R. Co. v. Int. Com. Comm.*, 206 U. S. 441, a case which arose prior to the Hepburn Act and the classification under consideration, the court, speaking through Mr. Justice McKenna, expressed itself regarding certain charges to operating expenses. Certain permanent improvements and equipment were charged to operating expenses, and in discussing the question whether this was a proper charge and whether it should be made in a single year, the court said:

It would seem as if expenditures for additions to construction and equipment, as expenditures for original construction and equipment, should be reimbursed by *all of the traffic they accommodate during the period of their duration*, and that improvements that will last many years should not be charged wholly against the revenue of a single year (p. 462).

The court then distinguishes the *Union Pacific Railway Co. v. United States*, *supra*, from a case involving rates. Referring to the interests of the shipper, the court said:

His right is immediate. He may demand a service. He must pay a toll, but a toll measured by the reasonable value of the service. The elements of that value may be many and complex, not always determinable, as we have seen, with mathematical accuracy.

but we think it is clear that instrumentalities which are to be used for years should not be paid for by the revenues of a day or a year; and this is the principle of returns upon capital which exists in durable shape (p. 463).

These cases do not in any sense justify the retaining of wreckage in the property account, but the reasoning, so far as it goes, does approve the general principles which have governed the Commission in the rules under consideration, in permitting the losses for abandoned property to be distributed over a period of years. Both of these cases arose before the passage of the act of 1906 and the classification made thereunder. They do not, therefore, aid very much in determining this case.

The other cases cited in appellant's brief to the effect that the owners of railroads have the right to determine the business policy of the road, and to initiate rates, is not denied, but as already stated in this brief, the bookkeeping does not interfere with the *proper* exercise of this power. No one can seriously contend that a system of bookkeeping and reports that prevents irregular methods is an interference with the proper exercise of discretion in determining business policy by the owners of the railroad. The public has the right to be protected from the payment of unreasonable rates to enable the company to pay returns upon fictitious values. It can not be said that a "property right" exists that enables the company to continue a method of bookkeeping which deceives the public regarding the value of the

property, or the operating expenses, and the net revenues.

Counsel for the appellant seems to reason that the company will be unable to proceed with necessary improvements unless it can pay for these improvements wholly out of the receipts from the sale of bonds; that bonds can only be sold when secured by a mortgage based upon an increase of the property account to the full extent of the money expended; and that it can not proceed if unable to secure credit by omitting proper charges to operating expenses and so create a fictitious balance. This line of argument carries with it a complete answer. If, to make improvements, it is necessary to deceive the public as to the value of the property operated by the company, or to produce an untrue balance of its operating or net revenues, it would seem that good policy would dictate either that the improvements be deferred until the revenues have increased, or that the stockholders voluntarily relinquish their dividends for a time in the hope of receiving larger dividends when the improvements are made. This is a matter of business policy to be determined by the directors. The book-keeping is a matter of regulation, determined by the legislative will, and Congress may determine which of the two methods of bookkeeping it will adopt—that practiced by the best-managed roads or that adopted by the roads that are struggling to borrow money upon fictitious statements of assets.

*Abandoned property "good of its kind."* Another fallacy in the argument is, that because an equipment



is "good of its kind" therefore its total abandonment is not depreciation. That is to say, if the company has ten engines of low power, for which it proposes to substitute ten engines of high power, when the new ones are placed in service and the old ones are scrapped, then, if the old ones were "good of their kind," the company may carry in its assets twenty engines instead of the ten actually in use. Or, if a railroad is 500 miles long and was constructed at an early period when obstacles were "gone around" instead of being crossed with bridges, or tunneled, and the company should determine to take out the curves and in doing so should abandon in the aggregate 50 miles of its road, reducing the line to 450 miles, then if the abandoned curves were "good of their kind" the railroad should still appear on the books as 500 miles long. The fallacy of these arguments appear upon their face when carefully considered.

*Double tracking.* The illustration as to the effect of building a second track fails utterly to state facts. If a second track is laid it adds so much to the value of the property and will be wholly charged to the property account. It is only abandonments or losses that are charged to operating expenses.

*Cost of progress.* Counsel designate abandonments as a "cost of progress" or "part of the cost of the new improvements." Under the rule of the Commission the loss *less salvage*, is taken out of the property account, yet counsel speak of this loss as a part of the cost of the improvement. Is another

part of their briet they speak of it as a "scaffolding" for making new improvements. The absurdity of this is, however, apparent when we consider that this loss, occasioned by the abandonment of property, has nothing whatever to do with, and does not form the slightest part of, the new line. The abandoned lines, except salvage, did not enter into or form any part of the material in the new improvements. It is simply wreckage; and the only question to be determined is, how shall it be disposed of in the accounts? Who shall pay for it, the public, by continuing existing rates until its value is earned, or shall the stockholders bear the whole loss by charging it to profit and loss? As a uniform rule to be applied to all roads the Commission reached the conclusion announced in the Union Pacific Case, *supra*, that *to encourage improvements* the public should bear its part. The property abandoned makes way for new and better construction or equipment; the loss is caused by the inadequacy of the old road or equipment. This falls clearly within the definition of depreciation. The new property is an additional asset, the old is scrapped and is a loss, and the loss is to be reimbursed out of earnings.

*Preponderance of testimony.* Counsel cite the number of witnesses testifying in appellant's behalf as though the questions involved were matters to be determined by a preponderance of testimony. The Government could have introduced many more witnesses in support of the rule, but, as we have before stated, this is not a question to be determined by

balancing the evidence. It was a legislative act. We introduced evidence simply to show that the order of the Commission was not arbitrary; that it was based upon sound principles; that prior to the action by the Commission the rule adopted was the practice of the strong and best-managed companies; in short, that the Commission had adopted a well-understood and highly approved method of disposing of the losses accruing through abandonment.

There are other specious arguments in the brief for the appellant that could be easily answered; but if the main objects of the rule are borne in mind they will not mislead.

The injustice to the public of the appellant's claim that this wreckage should be left in the property account is well illustrated in the cross examination of Mr. Seger. (Rec., vol. 2, p. 208.) This zealous witness follows the logic of his position to its conclusion. He says that if a piece of road had been moved twice to a new right of way, each time the cost of the new line being \$50,000 a mile, and the salvage out of abandoned property being \$10,000, he would retain in the property account \$130,000 per mile as the cost of the road operated, although its actual cost was only \$50,000 per mile. In such a case the public would be compelled to pay for all time rates high enough to produce an income on \$130,000 per mile for a road that actually cost \$50,000 per mile. This is the logical and inevitable result of the appellant's position. Rates would be exacted to pay income upon fictitious values; upon property having no existence whatever.

## NEW LEGISLATION.

*Congress has spoken directly upon this subject and made these regulations the law.*

In a recent amendment to the act to regulate commerce, approved March 1, 1913, Congress, in providing for valuation under a new section (19-a), declared:

That the Commission shall, as hereinafter provided, investigate, ascertain, and report the value of all the property owned or used by every common carrier subject to the provisions of this act. \* \* \* The Commission shall make an inventory which shall list the property of every common carrier subject to the provisions of this act in detail and show the value thereof as hereinafter provided, and shall classify the physical property, as nearly as practicable, *in conformity with the classification of expenditures for road and equipment as prescribed by the Interstate Commerce Commission.* \* \* \* *And all rules and regulations made by the Commission for the purpose of administering the provisions of this section and section 20 of this act shall have the full force and effect of law.*

This act was adopted by Congress with full knowledge of, and with direct reference to, these rules and regulations adopted and promulgated by the Commission under section 20 and now under consideration, and knowledge that these rules and regulations had received the approval of this court in the *Goodrich* case. This, therefore, is a legislative recognition and approval of the commission's rules and regulations made under section 20, and a declaration

that they shall have *the force and effect of law*. It recognizes also the classification of property and accounts by its declaration that the valuation to be made under the new act shall classify the railroad property "as nearly as practicable, in conformity with the classification of expenditures for road and equipment *as prescribed* by the Interstate Commerce Commission." This act, therefore, has direct reference to the classification of accounts already made by the Commission and is an affirmance and legislative approval of the classification. If, therefore, Congress has the power by direct act to so classify the accounts, it has exercised that power directly by its recognition and affirmance of the classification made by the Commission. This should dispose of the controversy in this case. The powers under section 20 have been clearly sustained by the courts and Congress has adopted the classification made thereunder by the Commission.

*Fifth amendment.* Does the requirement that the cost, less salvage, of abandoned property be taken out of the property account and charged to operating expense violate any constitutional right guaranteed to the petitioner?

In *Buttfield v. Stranahan*, *supra*, the court said (p. 492):

In examining the statute in order to determine its constitutionality we must be guided by the well-settled rule that every intendment is in favor of its validity. It must be presumed to be constitutional, unless its repugnancy to the Constitution clearly appears.

It was held that the right to import was not a right that could not be curtailed and regulated. The right of the petitioner to have records and accounts of its financial transactions put before the public in a particular way is not a property right which can not be curtailed or regulated by Congress. It is admitted that the petitioner is a carrier subject to the act to regulate commerce. As such carrier it is, therefore, subject to the plenary regulating power of Congress. Requiring its accounts to be stated in a particular way as Congress, acting through the Commission and since by direct action, has classified them, does not take away or destroy any property, or any property rights guaranteed by the Constitution.

There are cases that might be cited in support of this proposition. It is quite sufficient, however, to refer again to the *Goodrich Transit Company* case, where the court, passing upon this express question, said: "*We think the uniform system of accounting prescribed and the report called for are such as is within the power of the Commission to require under section 20 of the act. Nor do the requirements exceed the constitutional authority of Congress to pass such a law*" (p. 216).

Upon the authorities cited, we ask that the decree of the Commerce Court be affirmed.

Respectfully submitted,

CHARLES W. NEEDHAM,

*Assistant Solicitor,*

*Interstate Commerce Commission.*

Justice Supreme Court, U. S.

FILED.

OCT 28 1913

IN THE

Supreme Court of the United States

OCTOBER TERM, 1913.

No. 571.

THE KANSAS CITY SOUTHERN RAILWAY  
COMPANY,

*Appellant,*

*against*

THE UNITED STATES OF AMERICA,

*Respondent,*

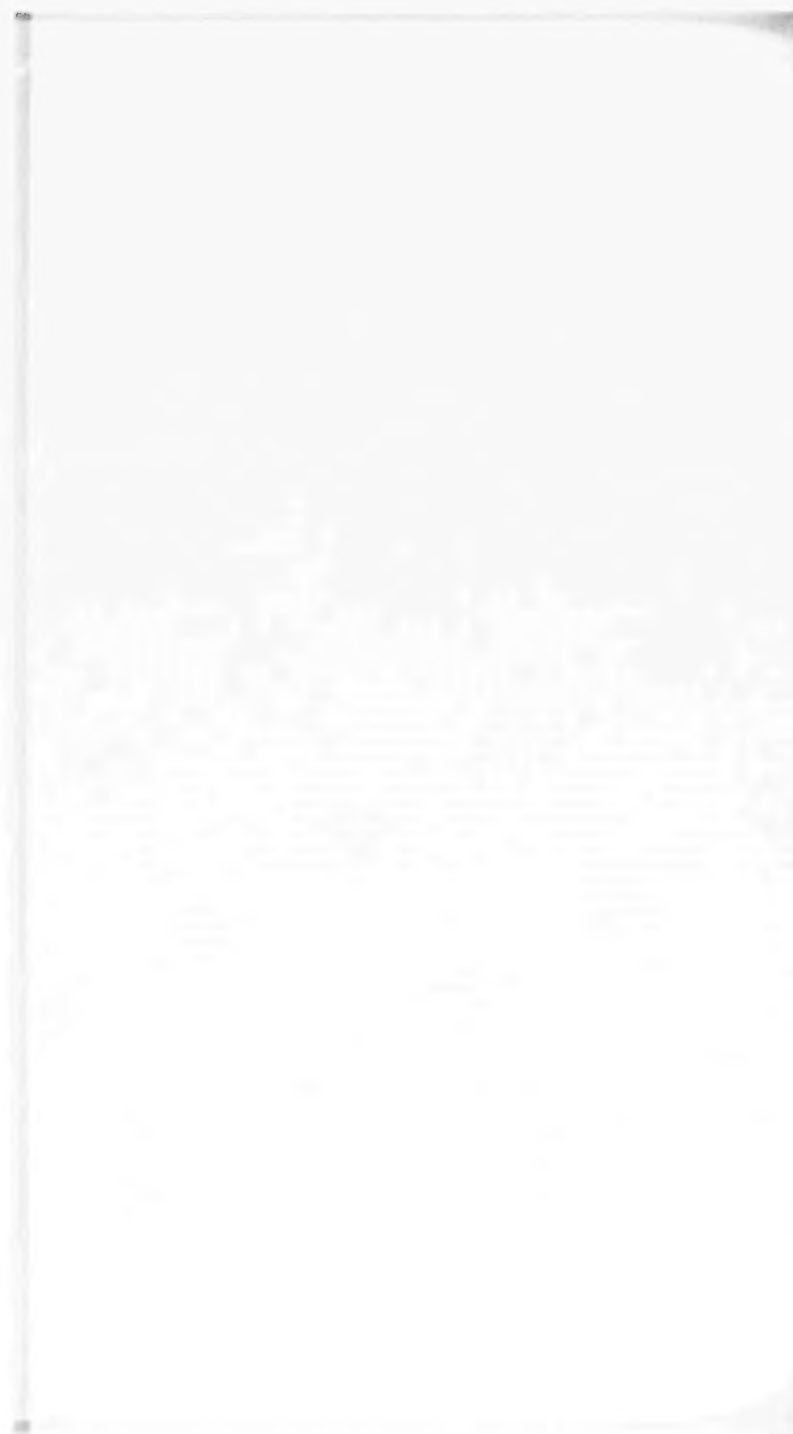
INTERSTATE COMMERCE COMMISSION,

*Intervening Respondent.*

APPELLANT'S BRIEF IN REPLY.

SAMUEL UNTERMYER,  
WALTER C. NOYES,  
ARTHUR M. WICKWIRE,  
IRWIN UNTERMYER,

*Solicitors for Appellant.*





IN THE  
**Supreme Court of the United States.**

THE KANSAS CITY SOUTHERN  
RAILWAY COMPANY,

*Appellant,*

*against*

THE UNITED STATES OF AMERICA,  
*Respondent,*

INTERSTATE COMMERCE COMMISSION,  
SIX,

*Intervening Respondent.*

**APPELLANT'S BRIEF IN REPLY.**

*The Appellant's Argument not Answered.*

The attention of the court is directed to the fact that both the brief submitted by the Interstate Commerce Commission and the brief submitted by The United States, ignore the fundamental argument advanced in our main brief—that power of the Commission to prescribe the “form” of accounts, does not involve power to control the administration of the company’s affairs in matters not otherwise within its authority.

Three important propositions of statutory interpretation are presented in our main brief, as follows:

- (1) The power to prescribe "form" cannot be extended to the control of matters of substance not otherwise within the authority granted to the Commission and that this order involves an attempt to exercise substantial control over the carrier in the management of its own affairs.
- (2) The power to prescribe the "form" of accounts is limited by other portions of the section which require the annual reports to show the "operating and other expenses," "the cost and value of the carrier's property," "the amounts expended for improvements each year," and "the balance of profit and loss."
- (3) Since Congress alone can exercise legislative power and since the matters embraced within the order are matters of public policy requiring legislative discretion for their determination, an interpretation of Section 20 which would be broad enough to sustain the order, would convert the grant of authority to the Commission into a delegation of legislative power and should therefore be avoided.

The omission of any effort to controvert any of these fundamental objections to the Commission's order can only be regarded as an admission that they are not subject to refutation.

Both briefs apparently advance the following contentions, which we shall consider *seriatim*:

*That it is necessary to charge property abandoned in connection with improvements, to operating expenses in order to enable the Commission*

*to determine the reasonableness of rates and to prepare their annual statistics along uniform lines.*

It is by no means a necessary consequence of our contention that the Commission may not require whatever explanation may be desired concerning the carrier's accounts. It may require any information concerning receipts or expenditures, and may classify them, for its own use, as it sees fit. So far as the Commission is concerned the result would be precisely the same, for the entry on the carrier's books would be accompanied with whatever explanation might be deemed necessary. The property account could be subdivided so as to show, as a separate item, the cost of property abandoned as an incident to permanent improvements and the compilation of statistics by the Commission could be made accordingly. The convenience of the Commission would be fully served and the railroad would not be compelled to allocate an item according to what is believed to be a false and pernicious method of accounting and one which will work irreparable loss to the company and its stockholders.

It has been conceded that the Commission has full authority to require any details which it may desire. By requiring such details in matters of additions and betterments, it can accomplish all the results which it would be able to accomplish by means of the order complained of. By requiring the carriers to show, as a separate item in the property account, the value of the line abandoned as an incident of the improvement the Commission could obtain all the information which it can acquire by the enforcement of this order and could secure the data for such adjustments as it

might feel authorized to make, including the particular adjustment which is the subject of controversy in this case.

Counsel for the Interstate Commerce Commission advances the following argument on this point (*page 26*):

"To make this classification accurate and uniform for comparison and other purposes, the Commission is authorized to make more specific and detailed specification of the general classification and to see to it that the grouping of items under each general head will result in giving a truthful statement in each account and in the annual balance sheet. *The policy of the railroad carrier is not controlling in this matter. There is no attempt to control the company in making reports to its stockholders or in making statements to its fiscal agents. It may report and state its accounts to them as it pleases and may state what it pleases. This regulation controls only the property accounts which are kept pursuant to the act of Congress.*"

The infirmity in this argument lies in the fact that it ignores that provision of the statute which prohibits and punishes the keeping of any other accounts, records or memoranda. How can the company make reports to its stockholders or fiscal agents if not permitted to keep accounts from which such reports may be made? How can it "state its accounts to them as it pleases and what it pleases," when the only account, record or memoranda which it is permitted to keep, declares that \$400,000 out of \$600,000 expended in improvements has been paid for by operating revenue? The policy of the railroad carrier is controlled in this matter and it is controlled on a most important question and in most unequivocal terms.

*The contention that the order is an indulgence to the petitioner and will prevent the reduction of rates until the time when the abandoned property has been paid for by the public.*

This may be true in cases where the conditions under which the road operates are not competitive and where it may therefore, with profit, avail itself of an increase in rates. It is not true in the present case for two reasons:

First, the evidence shows that during the year 1912 the Petitioner earned less than three per cent. on its capital investment. Clearly, therefore, no reduction of the rates of the petitioner would be possible without being confiscatory, and the addition to the operating expenses of the road of the sum of \$400,000 is of no value to the petitioner in preventing a reduction of its rates.

This clearly appears at page 128 of the "Preliminary Abstract of Statistics of Common Carriers for the year ended June 30, 1912" of the Interstate Commerce Commission.\*

KANSAS CITY SOUTHERN—Year ended 6 30 12.

Road and Equipment	\$81,737,457
Rail operating revenues	9,272,859
"    "    expenses	6,332,839
Net rail operating revenue	\$2,940,020
Taxes	410,369
Operating income	2,529,651

**Note.**—By stipulation (*Record, Vol. II, page 327*) it was agreed that the reports of the Interstate Commerce Commission might be used by either party as evidence in this case.

## Other Income:

Joint facility rents.....	\$74,054	
Misc. rents.....	10,312	84,366
		<hr/>
Gross income.....		\$2,614,017

## Deductions from Income:

Hire of equipment.....	\$217,522	
Joint facility rents.....	28,964	
Misc. rents.....	1,536	248,022
		<hr/>
Net income.....		\$2,365,995

*Per cent. on cost of road.....2.89 per cent.*

Secondly, the testimony shows that the conditions under which the petitioner operates are highly competitive (*Testimony p. 3*) and that the traffic will not bear a higher rate than that charged by its competitors (*Rec. Vol. II, p. 15*). It is evident that even if the Commission should consent to an increase in its rates the Kansas City Southern could not avail itself of this indulgence. Under these circumstances the public will not pay for the improvement. The improvement will be paid for by the stockholders who will suffer an irretrievable loss, in that they will neither be able to make the cost of the abandoned line a basis of better rates nor permitted to preserve an accurate record by means of which they could establish that cost as a part of the investment on which they are entitled to a reasonable return.

*The contention that the rule adopted by the Commission is in accordance with the best established practice.*

The suggestion is made by the Government that the Commission was justified in defining as "operating expenses" items which were not operating expenses because some railroads—not all—not a majority—but *some*, had at one time or another followed the practice prescribed by the Regulations. Mr. Adams, however, admits that the general practice in England has always been to the contrary (*Testimony p. 351*). The testimony of Mr. Bailey shows that the Santa Fe Railroad at one time found it impossible to charge property abandoned under similar circumstances to operating expenses, and that on application duly made, the Commission consented to transfer the charge to the profit and loss account (*Testimony pp. 323, 324*). It further appears that prior to the adoption of this rule by the Commission, the Great Northern Railroad in some cases made no charge to operating expenses for abandoned property. Mr. Lutz, a witness for the Government, testified that for a period of twenty years during which he was connected as accountant with the Louisville and Nashville Railroad no charge was ever made to operating expenses for abandoned property under the circumstances disclosed in the case at bar (*Testimony, pp. 342, 343*). Mr. Adams admitted that none of the classifications of operating expenses, promulgated by the Commission, from July 31, 1888 to 1909, contained any provision for charging to operating expenses the original cost or estimated cost of abandoned property.

The further claim that the railroads which had followed the practice subsequently prescribed by the regulation were the "best managed" railroads, is wholly without support in the evidence.

*That a Committee of the Association of American Railway Accounting Officers favored the classification in question by a vote of ten to nine.*

The action of the committee on this occasion was after a very hasty and superficial consideration of the question involved, and the record shows that even this expression of opinion was subsequently nullified by the entire association on more mature thought (*Testimony*, pp. 65, 67, 219-220).

The statement at page 50 of the Commission's brief, that the result of the vote was changed "under the pressure of the Executives" is without support of any evidence. The question was indeed asked and was excluded. (*Testimony*, page 250). A similar suggestion appears at page 11 of the Government's brief.

*The opinion of the Commission's experts concerning the term "operating expenses" as used in the statute.*

As we have argued in our main brief, the advice or opinion of the Commission's accountants cannot be taken as evidence upon the question of the Commission's authority to make these regulations. The petitioner's rights do not hinge upon the precarious and uncertain opinions of individuals as to such questions as these, and the opinions of accountants to the effect that the regulations do not transcend the authority conferred upon the Commission by the statute, can in no way bind the Court in determining the questions of law involved. The question of what is an "operating expense" is one of law where, as here, the facts are undisputed.



*The argument that it was within the power of the Commission to define the term "operating expenses."*

This cannot be true since the term "operating expenses" is a part of the grant of power under which the Commission has made the order, and it is almost needless to observe that the Commission cannot define the scope of its own authority.

*The "simple and conclusive test" suggested by the Government.*

In the Government's brief (page 6) it is said that "a simple and conclusive test" of the appellants' proposition is, that if the property were sold at foreclosure, the purchaser would pay only for the property actually found, and not for the abandoned line. Mr. Lutz's testimony is cited in support of this contention. While he made this statement he substantially qualified it on further consideration, as clearly appears from the following (*Testimony*, pp. 284-285):

"Q. Suppose during the process of construction, running over a period of two or three years, it should be found, by reason of an extraordinary freshet, that the location of the road at a particular line was too low, or too near a river, and that it was therefore desirable and necessary, for the safety of operations, to relocate that portion of the line upon other ground; will you state to what account the cost of the original track upon the original location would be chargeable? A. *That would remain in the road and equipment accounts along with the cost of the new one.*

Q. Would that be found at the present time as cost of property visible upon taking an inventory? A. I suspect some trace of it might be found, and the circumstances under which it was constructed could be ascertained by the appraiser.

Q. But your definition implies the property which is now in use is all that can go into your property account. A. I said the cost of the property now in use.

Q. The cost of the property now in use? A. Yes.

Q. That property is no longer in use, is it? A. No; I presume that, assuming that you call that a separate property, it is not in use.

Q. Then you admit there are other items which properly will go into a statement of property accounts than those embodied in your original statement? A. No, I think that is comprehended by the general statement "the cost".

Q. But you have stated that it is the cost of property now actually in use, and this you have already said is no longer in use. A. Then I will modify my statement to the extent, that I will say that the property account should reflect the cost, taking into consideration all the elements of construction cost during the construction period leading up to the completion of the structure as turned over for operation."

The Government concedes that the cost of the "scaffolding" used in the construction of a house is a part of the cost of the house (Brief, page 5), but it is evident that the purchaser at foreclosure does not buy the "scaffolding" which has been discarded after the house is built.

*This case does not involve any question of obsolescence.*

We have already referred to this question at considerable length in our main brief (*Appellant's Brief*, pp. 53-55). Both the brief of the Government and that of the Interstate Commerce Commission advance the argument that obsolescence is a form of depreciation, that depreciation is an operating expense and that therefore the abandoned sections of roadbed should be paid for out of operating revenue. This argument involves the false assumption that this case presents any question of obsolescence. It may be that obsolescence or as it has sometimes been called "functional depreciation" is a proper charge to operating expense. But in order that there shall exist any obsolescence the old utility must have been rendered obsolete by an improved utility. An illustration of such a case is given by Professor Cooley in describing depreciation due to obsolescence, and is set forth in full at page 48 of the Interstate Commerce Commission's brief.

There is, however, a material distinction which both the Government and the Commission have failed to recognize. In the illustration given of locomotives and cars the substitution was made necessary by the progress of the art which took place after the original equipment was acquired and rendered that equipment obsolete. The size and capacity of the locomotives had increased from year to year and the increased size of the locomotives necessitated the improvement of the track, structure and bridges. In other words, the equipment and the track had become obsolete due to the progress of the art.

In the case at bar, however, there has been no change in the science of engineering as related to the construction of the road. Were it not for the fact that a greater volume of traffic is now offered to the road, no change would be necessary or even desirable. At the time the line was constructed the fact was as clearly understood as it is today, that a locomotive can haul twice as much tonnage on a one-half of one per cent grade as it can on a one per cent grade. How then can it be said that the road has become obsolete?

The change of grade at this time is not due to any change in the science or the art. It is due to an increase in the volume of business offered to the road which *it was necessary to develop to a point where the increased investment could be justified.*

Counsel makes the suggestion that the change in grade was made to "improve" the Petitioner's facilities, thus implying that the roadway was defective in some way. The fact is, as we have already pointed out, that the change of grade was made to *enlarge* the facilities in order to provide for greater traffic.

*Assuming that the abandoned property should be deducted from the property account neither the Government nor the Commission advance any sufficient reason why the cost of the property abandoned should not be charged to profit and loss.*

The brief for the Government contains an important admission on this point. Referring to "functional depreciation" it is said (*page 8*):

"Where convenient (functional depreciation) should be provided for by a *sinking fund*

*created out of the earnings of the property during its period of productivity."*

If for any reason the property abandoned should be deducted from the capital account, it would seem that upon this statement of the Government, it should be charged to profit and loss, which is "a sinking fund created out of the earnings of the property during its period of productivity." Certainly, it should not be paid for out of operating revenue after the abandonment has taken place. During the life of the abandoned property it should constantly accumulate sufficient earnings to pay for the property when the abandonment becomes necessary. These earnings have, in fact, accumulated and are represented by the company's surplus or profit and loss account.

Similar admissions may be found in the brief of the Interstate Commerce Commission (pp. 45, 46):

*"Suppose, for instance, a trunk line has a branch from its station A to point B at right angles to the main line. Finding that this branch is not profitable it is abandoned, the track is taken up and is not replaced in kind—that is, the territory is not served by any new railroad. That line then ceases to be an earning instrumentality. Nothing will accrue to the stockholders in the future because of it. It has served its purpose and only past operations have benefitted from it. The results of the past operations not distributed to the stockholders are represented in the profit and loss account. Therefore this abandonment or depreciation is chargeable to the accumulated profits which have been earned during the period of its operation."*

It is evident that if these contentions are correct, the argument is fully applicable to the abandoned sections of road which the respondents claim to have perished as useful property. The fact that the abandoned sections have been replaced with more efficient instrumentalities has nothing to do with the question, for it is conceded, both by the Government and by the Commission, that the improvement, less the abandonment, is a capital charge.

A further inconsistency in the regulations should be here referred to. Under Section 8 of the Classification the petitioner might, years ago, have set up a "special fund" to be applied to the abandonment whenever it should become necessary. Had this been done, its present surplus would have been smaller by exactly the amount of the reserve thus set aside to meet the charge for the abandoned property.

If the petitioner had secured the consent of the Commission to pursue this course, the abandoned property would have been paid for by a sum which had been diverted from the profit and loss account. But because a "special fund" was not set up by permission of the Commission, it is argued that the abandoned property must be paid for out of operating expenses and not out of the company's surplus. In other words, if the consent of the Commission is obtained, the charge to surplus of property abandoned under these circumstances is a proper one; if however, the consent of the Commission is not obtained, the character of the charge for the same abandonment is completely changed and it must be made to operating expenses.

*That the Regulations do not affect the proper administration of the funds.*

We do not claim as seems to be supposed both by counsel for the Government and the Commission that the regulations impair the rights of either party under the mortgage. We contend however that the company had the right to finance the full cost of these improvements out of the proceeds of a bond issue and that the regulations are a direct veto upon the action of the directors in this respect. The result of the transaction as it must appear under the regulations of the Commission is demonstrated by the concluding sentence of the Government's brief, at page 18:

"The abandoned property is carried in suspense until paid for out of earnings."

These regulations, therefore, not only impair but directly veto the determination of the Board of Directors who, in the exercise of their judgment, have concluded to pay for these improvements (*whatever the character of the expenditure may be*) out of the proceeds of a bond issue. *It is admitted* that under the regulations \$400,000, out of an improvement costing \$500,000, must be paid for out of earnings.

In the Commission's brief it is asserted that the Regulations do not prevent the proper application of the borrowed money to the purposes for which it was appropriated. This we deny. We have shown in our original brief, and cited Mr. Adams' testimony to prove it, that the advance or loan from the bond account will have to be repaid, leaving the money (or its equivalent) unexpended, notwithstanding the determination of

the directors to spend it; and requiring the money to be paid out of operating revenue—thus reducing the current cash surplus available for dividends. At page 43 of the Commission's Brief our conclusion on this question is admitted:

*"If they choose to put it that way there is \$400,000 of the borrowed money still remaining."*

And at the sixth line, page 43, of the Commission's brief, is given the following analysis of the cash on hand:

*"Revenue withheld from surplus  
on account of abandoned property  
charged to operating expenses . . . . \$400,000."*

This statement clearly betrays the fact for which we have contended, that the regulation in question indisputably interferes with the internal management of the petitioner's business. The phrase "withheld from surplus" only thinly veils the fact that the money goes back into the bond account. Certainly it belongs either in the bond account or in the revenue account. If it properly belongs in the revenue account there is no reason why it should be "withheld from surplus." The only reason why it is "withheld from surplus" is because it has become a part of the bond account.

The statement at page 43 of the Commission's brief that

*"A charge to operating expense not requiring the payment of cash only reduces the net revenue applicable to dividends"*

confesses everything for which we contend. Where does the statute delegate the power to the



Commission to prescribe regulations which shall "reduce the net revenue applicable to dividends?" Is this included in the grant of power to prescribe "the form of accounts?"

*The rights of the preferred stockholders are injuriously affected by these regulations.*

The suggestion is made by counsel for the Government that the rights of the preferred stockholders are not affected since the Interstate Commerce Commission might consent to spreading the charge over a period of ten years. But, the validity of the order must be tested, not by what the Commission may accede to as a matter of favor, but by what the petitioner is entitled to demand *under the order* as a matter of right. This more clearly appears if we consider the result to the appellant of an affirmance of the judgment. Let it be supposed that the Commission then, in its discretion, should deny the application to spread the charge over a term of years and that the petitioner should again appeal to this court. Manifestly, the court under these circumstances could not grant the petitioner relief since by the very terms of the regulations the application was addressed exclusively to the discretion of the Commission.

It is also said that the dividends on the preferred stock will not be affected if the charge is spread over ten years. This may or it may not be so, depending entirely upon the success of the company's operations during the ensuing ten years. If the earnings of the company are maintained, it is true that the dividends will not necessarily be curtailed. If, however, the earnings

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of the company should for any reason be reduced, it is evident that the charge, even though spread over a term of years, might, and probably would, require a reduction of the dividend.

It must be apparent that the preferred stockholders have just cause to complain, even though the Commission has reserved the right to exercise a discretion in their favor, and even though, assuming that it should be disposed to exercise it, injury to the preferred stockholders is not inevitable.

*The Goodrich Transit Company case.*

The only questions involved in this decision were: (1) That Congress had power to authorize the Commission to establish a uniform system of accounts and to require annual or periodical reports, and (2) That such accounts and reports might include all the transportation business of companies engaged both in transportation subject to the Act to Regulate Commerce and in transportation not subject to that Act.

The legality of the special regulations made under this authority was not at issue in that case and was not, and could not have been, decided on the record then before the court. The suggestion was not made that there was any effort, by means of these regulations, to control the business of the Goodrich Transit Company. The opinion of the court is limited to the decision of the question that "the requiring of *information* concerning a business is not *regulation* of that business." In other words, that the Commission might by means of these accounts require any *information* concerning all the transactions of the carrier but that it

might not engage in the *regulation* of their business.

It is true that the decision in the Goodrich Transit Company case affirms the power of Congress to make the delegation in Section 20 under which the Commission *claims* to have acted in making the order here in controversy, but the only proposition advanced in the case at bar which might be thought to be affected by this conclusion is very different, viz., *that the grant of authority to the Commission cannot be construed as sustaining this order, because, so construed, it would amount to an unconstitutional delegation of legislative power.* In the opinion in the Goodrich case Mr. Justice Day, speaking for the majority of the Court, said:

“Furthermore, it is said that such construction of Section 20 makes it an unlawful delegation of legislative power to the Commission. We cannot agree to this contention. The Congress may not delegate its purely legislative power to a commission, but, having laid down the general rules of action under which a commission shall proceed, it may require of that commission the application of such rules to particular situations and the investigation of facts, with a view to making orders in a particular matter within the rules laid down by the Congress. This rule has been frequently stated and illustrated in recent cases in this court, and needs no amplification here. *Buttfield v. Stranahan*, 192 U. S. 470; *Union Bridge Co. v. U. S.*, 204 U. S. 364; *U. S. v. Grimaud*, 220 U. S. 506.

In Section 20 Congress has authorized the Commission to require annual reports. *The Act itself prescribes in detail what those reports shall contain.* The Commission is permitted, in its discretion, to require a uniform

system of accounting, and to prohibit other methods of accounting than those which the Commission may prescribe. In other words, Congress has laid down general rules for the guidance of the Commission, leaving to it merely the carrying out of *details* in the exercise of the power so conferred. This, we think, is not a delegation of legislative authority."

This is nothing more than a general declaration that on its face the authority granted to the Commission in Section 20 is within the limits of those discretionary powers that may be exercised by administrative agencies acting under a legislative grant of authority. This is very different from a declaration that a specific act, claimed to be done under that authority, is not one requiring essentially legislative discretion, and our precise contention is that this grant of power cannot be construed as broad enough to sustain this order *because* the making of that order required the exercise of exclusively legislative discretion and, hence, if construed so as to sustain it, the grant would be void as an unconstitutional delegation of legislative power.

Both the brief for the Department of Justice and that for the Interstate Commerce Commission, contain numerous characterizations of the order in terms that indicate the exercise of legislative discretion. Certainly only Congress could establish a general rule of "indulgence to the railroads as against the public" (Government's brief, page 9) or a general rule as to whether or how long abandoned property should remain as a part of the cost upon which the carrier is entitled to earn a reasonable return. Perhaps the Commission

might determine this in a particular case, after hearing, but to make a general rule for all cases must be a legislative act. Such rules are "laws of wide import,"

"instances of general legislation requiring an exercise of law-making power, and \* \* \* undertaking to change the laws and customs of transportation in the promotion of what is supposed to be public policy." (*Texas & Pacific vs. Interstate Commerce Commission*, 162, U. S. 197, 234.

and—

"It is also obvious if the Commission does have the power, of its own motion, to promulgate general decrees or orders which thereby become rules of action to common carriers, such exercise of power must be confined to the obvious purposes and directions of the statute. Congress has not yet seen fit to grant legislative power to the Commission." *Texas & Pacific vs. Interstate Commerce Commission*, 162, U. S. 197, 216.

Yet, in the brief filed on behalf of the United States it is said:

"If this abandoned property is charged to surplus it is an immediate dead loss to the stockholders, whereas if it is charged to operating expense it remains, until satisfied, as a basis for rate charges. This is the policy of the Commission's order and it is an indulgence to the railroad as against the public, due to the fact that the abandonment might have been provided for in advance by a reserve fund out of earnings and so have justified higher rates in the past during the period of its actual depreciation." (*Brief of the United States page 7*).

Counsel for the Interstate Commerce Commission, goes even so far as to *assert* that in making the challenged order "the Commission was acting in purely a legislative capacity," (p. 35) and his assertion is well borne out by the balance of his argument. For example, referring to the purpose of the Commission in making the order,—

"It was not a question of business policy but of public justice that became the controlling motive in this work" (p. 11).

The establishment of a general rule of justice is not matter of administration; it is matter of legislation. Again, what shall be encouraged by general rules and what discouraged is for the legislature alone to determine. Yet counsel for the Commission says:

"Another important matter for consideration was the encouragement of all sound plans for the improvement and betterment of railroads" (p. 14).

See also the Commission's brief page 39, 40, 55 and 56.

It seems perfectly clear that the order in controversy prescribes a general rule of conduct for interstate railways, depending upon public policy for its sanction and hence beyond the power of any administrative agency, even though Congress had attempted in most definite terms to make the delegation. To read into Section 20 such a congressional intent would make it unconstitutional, and the Courts will avoid such a construction (*United States v. Delaware & Hudson Company*, 213 U. S. 366, 407) and even those that would raise grave constitutional doubts (*U. S. v. Delaware & Hudson*

Company, 213 U. S. 366, 408; *Harriman v. Interstate Commerce Commission*, 211 U. S. 407).

Our proposition in this case that the power to prescribe the forms of accounts cannot extend to matters of substance, or in other words, be so construed as to sanction the exercise by the Commission of any substantial control over the carriers in matters not otherwise within its powers, such as to determine the funds out of which improvements shall be paid for or the dividends to be paid, is greatly strengthened by the *Goodrich Transit Company* case where the Court said:

"The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is *not* to enable it to *regulate the affairs of the corporations not within its jurisdiction*, but to be *informed* concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction."

and—

"Further, the requiring of *information* concerning a business is *not regulation* of that business."

These quotations show that the Court had very clearly in mind the plain distinction between a regulation that would make the information in the accounts accurate and accessible by insuring uniformity in the bookkeeping forms and a regulation which, although in the guise of requirements directed to the forms, would actually control the methods and acts that the books record. One is a control of the records, the other of the acts of the corporation. One is control of form,

the other control of substance. On this point the Court observed:

"Bookkeeping, it is said, is not Interstate Commerce. True, it is not. But bookkeeping may and ought to show how a business is carried on, in order that the Commission charged with the duty of making reasonable rates and prohibiting unfair and unreasonable ones, may know the nature and extent of the business of the corporations, the cost of its interstate transactions and otherwise to inform itself so as to enable it to properly regulate the matters which are within its authority."

*The Act of Congress approved March 1, 1913.*

The suggestion is made (*Interstate Commerce Commission's brief, page 62*) that the recent amendment of the Act to Regulate Commerce, approved March 1, 1913, has legalized the action of the Commission in this case. Of course, if the regulations in controversy be treated as a part of this legislation, they will take effect as legislation only from the date when the Act of Congress took effect. As legislation, the regulations have no retroactive effect.

The legislation in question is part of what is known as the "Physical Valuation Law." The fact that Congress has enacted that *hereafter*, in classifying or fixing the physical valuation of railroad property, the "classification of expenditures for road and equipment" as prescribed by the Commission, shall govern "*as nearly as practicable*", has no relation whatever to the proposition presented in this case as to the right of the Commission under the guise of prescribing the



"form of accounts" to require items to be charged to operating expense that properly belong in the capital or profit and loss account.

Under the Act in question, the physical valuation is subject to review, whilst it is here claimed that there is no review from the determination of the Commission.

Suppose the Commission in administering the Physical Valuation Act finds, (1) That in the case of road A the surplus or profit and loss account has been subdivided and an account set up under "Maintenance of Way and Structure" and the cost of certain property abandoned in connection with grade reductions have been charged against that account; (2) That road B has a much larger surplus account which has, however, not been subdivided and that it has made like grade reductions which have, however, been charged against operating expenses, so that the capital account has not thereby been reduced. Is it contemplated that in the physical valuation of these two properties the abandoned property shall be differently treated because of the differences in bookkeeping that have been sanctioned by these regulations of the Commission? Is the abandoned property to be included in the physical valuation in the one case and excluded in the other?

#### *Miscellaneous.*

The statement is made at page 57, of the Commission's brief that

"The bookkeeping does not interfere with the proper exercise of this power. No one can seriously contend that a system of bookkeeping and reports that prevents irregular methods is an interference with the proper exercise of discretion in determining business policy by the owners of the railroad."

This argument—that regulations which are limited to bookkeeping do not interfere with the determination of the policy of the carrier—is misleading. It fails to distinguish between bookkeeping and railroading. Bookkeeping must be truthful and accurate, and the Commission may prescribe the method by which the corporation's transactions shall be recorded, but it has no power under Section 20 or through any system of accounts to control the transactions themselves which constitute the basis of the bookkeeping.

Mr. Seger's position, as disclosed by the testimony referred to by counsel for the Commission (page 61) is perfectly logical. The Commission admits that all sections of track abandoned, each costing \$50,000, must in some way be paid for by the public. This is an obligation which the Commission admits the public ought not to avoid. What difference can it make so far as the public is concerned, whether it makes payment to the carrier for the entire loss at once or whether the item is allowed to remain as a loan from the carrier upon which the public will continue to pay a fair return?

At page 49 and elsewhere, counsel for the Commission emphasizes the fact that the improvements were made "for the benefit of the future." This is relied upon to show that this case involves a question of depreciation. How improvements could be *made today* for the benefit of *the past*, it is not easy to imagine. Nevertheless it is claimed that the fact that these improvements were intended for *the future* distinguishes the case so that it comes "directly within the rule."

In this connection it should be noted that the Company had fully committed itself to this program of improvement *before the promulgation of the regulations in question*. Mr. Burt's examination and report were first obtained at an expense of about \$150,000 (*Testimony, pp. 4-5*). The directors passed resolutions providing for the issuance of the bonds in April, 1909; the stockholders adopted resolutions approving the issuance and sale of the bonds for these purposes on June 29, 1909; the mortgage was dated as of July 1, 1909, and actually executed on June 30, 1909; the bonds were negotiated and sold at or previously to this time; and it was not until August 15, 1909, that the Petitioner had notice of the promulgation of the regulation complained of, which was issued by the Commission at or about that date, although the order promulgating it stated that it was effective on July 1, 1909 (*Testimony, pp. 11-32*).

The argument is made at page 45 of the Commission's brief that "the abandonment is a loss and the account should show it." The appellant is quite willing that the accounts should show the abandonment and has offered to set up the amount in a special fund to be labeled either "Property Abandoned as an Incident to Improvements" or any other appropriate heading.

**The decree should be reversed.**

SAMUEL UNTERMYER,  
WALTER C. NOYES,  
ARTHUR M. WICKWIRE,  
IRWIN UNTERMYER,  
*Appellant's Counsel.*

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KANSAS CITY SOUTHERN RAILWAY COMPANY  
v. UNITED STATES OF AMERICA AND THE  
INTERSTATE COMMERCE COMMISSION.

APPEAL FROM THE UNITED STATES COMMERCE COURT.

No. 571. Argued October 29, 30, 1913.—Decided December 1, 1913.

The constitutional validity of the provisions in § 20 of the Act to Regulate Commerce of February 4, 1887, c. 104, 24 Stat. 379, as amended by the Hepburn Act of June 29, 1906, c. 3591, 34 Stat. 584, giving the Interstate Commerce Commission authority to prescribe the methods by which interstate carriers shall keep accounts, has already been sustained by this court. *Interstate Commerce Commission*

The authority conferred upon the Commerce Court by the act of June 18, 1910, c. 309, 36 Stat. 539 (Judicial Code, § 207), with respect to enjoining or setting aside the order of the Interstate Commerce Commission, like the authority previously exercised by the Federal Circuit Courts, was confined to determining whether there had been violations of the Constitution, or of the power conferred by statute, or an exercise of power so arbitrary as virtually to transcend the authority conferred.

In enacting the Hepburn Act amending § 20 of the Act to Regulate Commerce, Congress recognized the essential distinctions between property accounts and operating accounts, and between capital and earnings, and that while prior to that time the practice of different carriers varied, uniformity in regard to the keeping of accounts was essential in the future for proper supervision and regulation.

*Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194, followed to the effect that there is no unconstitutional delegation of legislative power by Congress to the Commission in giving it authority to establish methods of accounts by the provisions of the Hepburn Act amending § 20 of the Act to Regulate Commerce in that respect.

The classification of accounts adopted by the Interstate Commerce Commission in regard to additions and betterments and to property and operating accounts are not so arbitrary or so entirely at odds with fundamental principles of correct accounting as to amount to an unconstitutional abuse of power.

In this case the carrier was not deprived of any of its property without due process of law because under the Commission's system of accounting it was permitted to carry into its property account only the excess of the full cost of improvements made off the line after deducting the estimated replacement cost of the abandoned portions of the track or because it was required to charge to operating expenses the estimated cost of replacing the abandoned sections.

Where, as in this case, all classes of stockholders of a carrier, whose dividends are affected by the method of charging betterments and repairs, are not before the court, their rights cannot be determined in a suit between the carrier and the Commission in regard to such methods of accounts.

*Semble*, that requiring stockholders to forego dividends for a period so that the amount not divided be spent in bettering the condition of the property, thus giving them greater security for dividends in the future, does not amount to an unlawful taking of property within the meaning of the Fifth Amendment.

A carrier is not relieved from complying with regulations properly

made by the Interstate Commerce Commission because of agreements previously entered into; whatever had been done was subject to being displaced by the Commission under the powers conferred upon it by Congress.

The power given to the Commission by § 20 of the Act to Regulate Commerce, as amended by the Hepburn Act, to require the carrier to keep accounts as prescribed by the Commission, does not impose obligations upon the carrier as to the use of the proceeds of bonds but simply prevents such proceeds from being used in any manner without the fact appearing in the accounts.

Although the contention of the carrier that abandonments ought to be charged to profit and loss rather than to operating expenses may have weight, this court will not reverse the order of the Commission requiring them to be otherwise charged on the ground that it was an abuse of power.

Where it appears that the Commission has acted fairly within the grant of power constitutionally conferred upon it by Congress its orders are not open to judicial review.

204 Fed. Rep. 641, affirmed.

This is an appeal from a decree of the Commerce Court dismissing appellant's petition in an action brought to have certain regulations of the Interstate Commerce Commission relative to the method of keeping the accounts of carriers declared invalid and to enjoin the enforcement thereof. 204 Fed. Rep. 641. The regulations are contained in the "Classification of Expenditures for Additions and Betterments of Steam Roads," effective July 1st, 1909, and the First Revised Issue thereof, effective July 1, 1910.

The facts as set forth in appellant's brief may be summarized as follows:

Appellant is engaged in interstate commerce. Its main line is about 786 miles in length and extends from Kansas City to Port Arthur, on the Gulf of Mexico, traversing the States of Missouri, Kansas, Oklahoma, Arkansas, Louisiana and Texas. The road was built years ago, when the country was heavily timbered and sparsely settled, and the traffic was correspondingly small. The traffic would not

then support, nor could capital be obtained for, an expensively constructed road; and in consonance with the general practice in the development of the country, the road was built with rather heavy ruling grades. But it was not defectively or improperly constructed or located; it had substantially the same grades as other roads then constructed in the west; and it was adequate to serve the then existing needs of the country. A railroad with heavy grades is, of course, more cheaply constructed than a road of low grades. And a road of heavy grades is generally adequate in a new country, where the volume of traffic offered is small, the train-loads light, and the trains few.

The ruling maximum grade of appellant's line as originally constructed was 1 per cent.; and in the mountain district as high as 1.35 per cent. The evidence is undisputed that it was properly located, well constructed, and ample for the needs of the country. In the course of time, with the development of the country, and the resultant increase in traffic, whereby the limit of the road's capacity was being approached, the conditions warranted and rendered desirable such additions or improvements as would enlarge the road's capacity, and permit traffic to be moved more rapidly and economically.

Two methods of increasing the capacity of the road were presented: one by double-tracking, the other by lowering the grades and thus permitting traffic to be moved more rapidly. The road was in active competition with powerful rivals operating in the same general territory; among them, the Southern Pacific, the Missouri, Kansas and Texas, the Missouri Pacific, the St. Louis Southwestern, the Texas and Pacific, the St. Louis and San Francisco, the Atchison, Topeka and Santa Fe, and the Rock Island. The character of the road as a trunk line, having a long average haul and the prevalence of low class traffic,—timber, coal, oil and like commodities—necessarily entailed a low average freight rate; its average rates per ton

per mile being lower than those of any of its competitors above named.

Under these conditions the management found that the most desirable plan was to lower the grades of the road, and thus to increase its capacity, procure economy in operation and render better service to the public. Two methods of reducing the grades at various points along the line were presented: one by raising or lowering the roadbed on the existing right of way; the other by the construction of short sections of new road in substitution for portions of the road, in instances where the same result could be thus obtained at less cost. The program of improvement contemplated, therefore, not only many changes on the original right of way, but also a number of changes by the substitution of short sections of road on new ground, where that method was more economical.

The first six sections of the road where new locations were utilized are covered by the petition herein. Other similar changes are being made as the work proceeds, which will cover several years and is estimated to cost \$3,000,000. The road at these six points was in no way worn out, was fully maintained, and was capable of performing for an indefinite term the function for which it was originally constructed. All of these changes are being made for the purpose of increasing the capacity of the line, of securing economy in operation, and of rendering improved service to the public.

At the six sections of the road in question it was found by the estimates of the engineers that the cost of securing the required gradient upon the original roadbed would be \$1,230,318.99; but that the same result could be obtained by means of re-locations upon adjacent land for a net expenditure of \$629,399.74.

The actual expenditure on these six new locations, as ascertained on completion of the work (after the filing of the petition) was \$763,798; and the testimony shows



that had the work been done on the original roadbed the cost would have been increased over the estimates in an equal or greater proportion; the variation being due to increase in the cost of labor, materials, etc. For present purposes, the figures set forth in the petition are adopted.

The grade revisions at the six sections of line involved herein having been completed by removing the tracks to adjacent parcels of ground, which were procured and substituted for the original parcels, the use of the latter parcels was, of course, discontinued.

The expenditure required to improve the property by bringing it to the desired grade of five-tenths of one per cent. being deemed a capital expenditure, appellant's directors determined to finance the work by applying to it the proceeds of a bond issue. It is claimed to have been necessary to finance the improvements in this way if they were to be made at all, because the appellant did not have current earnings available for these improvements, and could not have financed its program, involving the revision of about forty-one per cent. of the entire line and an ultimate expenditure of several million dollars, in any other way than by raising capital for that purpose through the issuance of bonds.

Appellant, in order to raise funds for this and certain other purposes, made an issue of bonds secured by a second mortgage on its property. This was duly authorized by the directors and stockholders in the month of June, 1909; a portion of the bonds was sold and an initial sum of \$1,250,000 thus obtained became applicable to the improvements referred to in the petition and other improvements in the grade. Additional bonds have since been issued as the work has proceeded.

In 1907, appellant began the payment of dividends at the rate of 4% per annum upon its preferred stock, the total amount of which was \$21,000,000, and has continued to pay such dividends each year until the present time.

These dividends are non-cumulative and are payable only out of the earnings of the current year. The fact that appellant had paid its dividends for several years was a factor in its credit. Preferred dividends having been established, it is claimed that their discontinuance would have affected the credit of the road so seriously that it would have been unable except on prohibitive terms to dispose of additional bonds as further money was required from time to time during the progress of the work. It is further claimed that appellant was able to finance its improvements only out of the proceeds of a bond issue; and that it could not have financed them at all except by adopting the economical method of making a considerable part of the grade reductions by means of changes off the line of the right of way.

Appellant having paid the cost of the six improvements out of its issue of bonds, was confronted with the regulations of the Commission bearing on the method of recording the transaction in its books of account. Except for those regulations, it is said that the full cost of the improvements would have been charged to the account of "Additions and Betterments"—a subdivision of the property accounts—and credited to the proceeds of the bonds, because that sum had been expended for additions and betterments, and because the bonds had supplied the funds. In the balance sheet the "Assets" would have shown an increment of approximately \$629,399 under the subdivision of Additions and Betterments, and, *per contra*, the "Liabilities" would have shown a corresponding increase under the subdivision of Bonds.

Under the regulations in question, it was found that if the improvements had been made on the original right of way, the entries would have been made as above indicated. But, with respect to improvements made off the right of way, different treatment was prescribed. Here the appellant was not permitted to carry into its property

accounts the full cost of the improvement, but was required first to deduct from the cost thereof the estimated replacement cost of the portions of track no longer used, the difference only being carried into the property accounts, and a sum equal to the estimated cost of replacing the old sections of track being charged to the operating expenses of that year.

The text of the Classification of Additions and Betterments relative to revisions made on the original line is as follows: "Grade Revisions.—(Reduction of grades by cutting down summits and raising sags without materially changing the alinement). The amount to be charged to this account is the cost of additional grading done, including as a portion of such cost the rent and cost of operation of steam shovels and work trains; building temporary tracks for steam shovels and grading outfits; tools, etc., used in the work; raising or lowering existing bridges; increasing the length of culverts and replacing riprap at culvert ends; changing grade crossings for farm or country roads, highways, and streets, including crossing gates, highway crossing alarms, and watch houses."

Relative to changes off the original line the regulation is as follows: "Changes of Line.—(Construction of new lines for the purpose of improving grade or alinement). The amount to be charged to this account is the difference between the cost of the new line and the cost of replacing in kind the line abandoned, exclusive of right of way."

The General Instructions contained in the Classification supplement these rules and prescribe charges to Operating Expenses as follows:

"5. In case it becomes necessary directly in connection with betterment or improvement work to abandon any property, the cost of replacing the abandoned property in kind plus the cost of removal but less the value of salvage, should be charged to the appropriate accounts under Operating Expenses. In case, however, the amount so

chargeable is large, and its inclusion in a carrier's operating expenses for a single year would unduly burden the operating expense accounts for that year, the carrier may, if so authorized upon application to the Interstate Commerce Commission, charge such cost to the Property Abandoned account provided in the Form of General Balance Sheet Statement, or to the reserve account mentioned in paragraph 6.

"6. When property is abandoned and not replaced, the original cost (estimated, if not known) should be credited to the appropriate additions and betterments accounts and charged, less salvage, to Profit and Loss Account, to which should also be charged all incidental expenses directly connected with the abandonment. If so authorized upon application to the Interstate Commerce Commission, however, a carrier may set up depreciation accounts under 'Maintenance of Way and Structures' for the purpose of creating a reserve to which (instead of Profit and Loss) should be charged the original cost, less salvage, of the property (other than land or equipment) abandoned, and all incidental expenses directly connected with the abandonment."

These are the regulations as they appeared in the Classification of 1909. In the First Revised Issue (1910) there were some slight changes, but none now important.

To restrain the enforcement of the regulations so far as they required or tended to require appellant to charge against its earnings the estimated replacement value (less salvage) of the six parcels of railroad line that were abandoned as an incident to grade reduction as above set forth, was the principal object of the suit.

The petition sets forth the following as a second ground of complaint. As a part of its program of improvements, appellant is engaged in erecting a new and enlarged shop and terminal plant at Shreveport, upon a different location from that of the existing shop and terminal plant,

which latter are incidentally to be abandoned. It is claimed that the present shop and equipment are not worn out or obsolete, but are in good condition, and capable, with ordinary running repairs, of performing for an indefinite time the functions for which they were originally constructed. Appellant desires to charge the estimated value of the abandoned shop and terminal plant, amounting approximately to \$100,000, against its accumulated surplus as represented in its profit and loss account. The regulations of the Interstate Commerce Commission relative to accounting, however, prohibit this charge, and require that the estimated replacement cost (less salvage) of the existing shop and terminal plant shall be charged to the Operating Expense Account. An injunction against the enforcement of the regulations in this regard also was prayed.

*Mr. Samuel Untermeyer*, with whom *Mr. Waller C. Noyes*, *Mr. Arthur M. Wickwire* and *Mr. Irwin Untermeyer* were on the brief, for appellant:

The power delegated to the Commission to prescribe the "form" of accounts cannot be extended so as to authorize the exercise of substantial powers of railway management not otherwise within its authority.

The regulations will curtail and may absolutely prevent the payment of dividends on the petitioner's preferred stock, which is non-cumulative and payable only out of the net earnings of each year.

The lawful determination of the petitioner to finance this improvement, costing \$600,000, out of the proceeds of a bond issue is vetoed to the amount of \$400,000 by the regulation which compels the petitioner to pay \$400,000 of the expense out of operating revenue and to restore that amount to the bond account and return it to the trustee of the mortgage.

Property abandoned as an incident to permanent improvements is not an operating expense.

**Petitioner** contends that since the original locations were necessary in the development of the line, and were abandoned only as an incident to the improvement and development of the property, the cost thereof being a part of the cost of progress should remain in the property account as a part of the stockholders' investment.

The original investment was necessary in order that the second investment might be made.

The theory of depreciation advanced in support of the regulations has no application to the facts of this case.

Even the theory on which the respondents attempt to support the regulations, does not, when analyzed, justify a charge to operating expenses, but at most, a charge to profit and loss.

Since the Act to Regulate Commerce penalizes the keeping of any other accounts, records or memoranda than those prescribed by the Commission, and since the act requires that the annual reports shall show in detail (1) the cost and value of the carrier's property; (2) the amounts expended for improvements each year; (3) the operating and other expenses and (4) the balance of profit and loss, the Commission cannot promulgate rules which would leave the carrier without a true record of the facts to be included in the annual reports.

If, under any circumstances, Congress had power to determine that accounts should be so kept as to include in operating expenses an item which is not an operating expense, and to interfere with the internal management of common carriers and to deprive stockholders of their dividends, the determination of such a public policy involves the exercise of discretionary legislative functions incapable of delegation to the Interstate Commerce Commission.

Since the regulations in question compel the petitioner to make false entries in its accounts and thereby deprive the preferred stockholders of dividends to which they are

lawfully entitled, the regulations are in violation of the Fifth Amendment to the Constitution of the United States.

In support of petitioner's contentions see *Charlotte, C. & A. R. R. Co. v. Gibbs*, 142 U. S. 386; *Fordyce v. Omaha, Kansas City & E. R. R.*, 145 Fed. Rep. 544; *Goodrich Transit Co. v. Int. Comm. Com.*, 224 U. S. 194; *Int. Comm. Com. v. Louis. & Nash. R. R. Co.*, 73 Fed. Rep. 409; *Int. Comm. Com. v. Chicago G. W. R.*, 209 U. S. 108; *Ill. Cent. R. R. Co. v. Int. Comm. Com.*, 206 U. S. 441; *Ill. T. & S. Bank v. Doud*, 105 Fed. Rep. 123; *Lackawanna Coal Co. v. Farmers' L. & T. Co.*, 176 U. S. 298; *N. Y., N. H. & H. R. R. v. Int. Comm. Com.*, 200 U. S. 361; *Pennoyer v. Con-noughby*, 140 U. S. 1; *Railroad Tax Cases*, 13 Fed. Rep. 722; *S. C.*, 116 U. S. 138; *Southern Pac. Co. v. Int. Comm. Com.*, 219 U. S. 433; *Smyth v. Ames*, 169 U. S. 466; *Santa Clara County v. Southern Pac. R. R. Co.*, 18 Fed. Rep. 385; *S. C.*, 118 U. S. 394; *Tex. & Pac. Ry. Co. v. Int. Comm. Com.*, 162 U. S. 197; *United States v. Verdi Copper Co.*, 196 U. S. 207; *United States v. Folk*, 204 U. S. 143; *Wisconsin & c. R. R. v. Jacobson*, 179 U. S. 287; *Un. Pac. R. R. Co. v. United States*, 99 U. S. 402; *Wood v. Guarantee Co.*, 128 U. S. 416.

Mr. Assistant Attorney General Denison, with whom Mr. Thurlow M. Gordon, Special Assistant to the Attorney General, was on the brief, for the United States:

In requiring that abandoned property (over and above salvage) should not be continued as an asset, the Commission does not act arbitrarily or injuriously. *Int. Comm. Com. v. Goodrich Transit Co.*, 224 U. S. 194; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Minnesota Rate Cases*, 230 U. S. 352; Physical Valuation Act, 37 Stat. 701.

Nor did the Commission act arbitrarily and injuriously in requiring that property abandoned in connection with improvements should be charged off through operating expense instead of through surplus.

The policy of the Commission is to allow an indulgence to the railroads by permitting them to maintain a basis for higher rates until the abandoned property has been paid for.

Obsolescence is depreciation and a proper and authoritatively recognized part of the definition of "operating expense." *Cumberland Tel. Co. v. Louisville*, 187 Fed. Rep. 637; *Columbus Light Co. v. Columbus* (Whitten, Valuation of Pub. Ser. Corp., § 450); *Eastern Case, Re Advances in Rates*, 20 I. C. C. 243; *Int. Comm. Com. v. Goodrich Transit Co.*, 224 U. S. 212; *Holyoke, Massachusetts, Purchase Case* (Whitten, § 454); *Knoxville v. Water Co.*, 212 U. S. 1; *Montgomery on Auditing* (ed. 1912), p. 319; *Brooklyn Heights R. R. Co. v. Tax Commissioners*, 69 Misc. (N. Y.) 646; *Queens County Water Co. v. Woodbury*, 67 Misc. (N. Y.) 490; *Queens Borough Gas Co.*, 18 N. Y. (reported in Whitten, § 487); *San Joaquin Co. v. Stanislaus County*, 191 Fed. Rep. 875; *Spokane &c. R. R.* (Whitten, § 457); *State Journal Printing Co. v. Madison Gas Co.*, 4 W. R. C. R. 501; (Whitten, § 486); *Third Avenue Reorganization*, 2 P. S. C. N. Y. July 29, 1910; (Whitten, § 463); also Whitten, §§ 450, 451, 452, 453, 458, 481.

Even if dividends should be lost owing to the abandonment of property, such loss is no reason for invalidating this order. *Molloy's Case*, 219 U. S. 467.

But there is no reason to assume that the Commission will refuse to spread the charge so as to avoid such a result.

The required system of accounting does not "veto" the terms of the mortgage.

For other cases in support of contention of the United States see *Bullfield v. Stranahan*, 192 U. S. 470; *Columbus Ry. & Light Co. v. City of Columbus* (Whitten, § 450); *Cumberland Tel. & Tel. Co. v. City of Louisville*, 187 Fed. Rep. 637; *Eastern Case, Re Advances on Rates*, 20 I. C. C. 243; *Holyoke, Mass., Purchase Case* (Whitten, § 454);



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*Illinois Central Case*, 215 U. S. 452; *Int. Comm. Com. v. Goodrich Transit Co.*, 224 U. S. 191; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Minnesota Rate Cases*, 230 U. S. 352; *Montgomery on Auditing, Theory, and Practice*; *Motley's Case*, 219 U. S. 467; *People ex rel. Brooklyn Heights R. R. Co. v. Tax Commissioners*, 69 Misc. (N. Y.) 646; *People ex rel. Queens County Water Co. v. Woodbury*, 67 Misc. (N. Y.) 490; *Queens Borough Gas & Elec. Co.*, 2 P. S. C. 18 N. Y. (Whitten, § 487); *San Joaquin Co. v. Stanislaus Co.*, 191 Fed. Rep. 875; *Spokane & Inland Empire Elec. R. R.* (Whitten, § 457); *State Journal Printing Co. v. Madison Gas & Elec. Co.*, 4 W. R. C. R. 501 (Whitten, § 486); *Third Avenue Reorganization* (Whitten, § 463); *Union Pacific Case*, 222 U. S. 541; *United States v. Grimaud*, 220 U. S. 506; (Whitten, Valuation of Public Service Corporations, §§ 450, 451, 452, 453, 458, and 481).

*Mr. Charles W. Needham* for the Interstate Commerce Commission:

The power of Congress over interstate commerce includes regulating the forms of accounts and reports which have a substantial relation to the regulation of commerce.

Public records are exclusively under public control and Congress has power to vest Commission with authority to determine classification of accounts of common carriers.

The Commission's order is an extension of congressional action and in prescribing the classification of accounts, etc., the Commission was acting in purely a legislative capacity, nor did it act arbitrarily in requiring such classification.

By the Commission's system of classification there was no destruction of property nor was the administration of the funds affected.

Constitutional rights were not violated by the orders involved.

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Congress has spoken directly on this subject and made these regulations the law and there is no violation of the Fifth Amendment.

In support of these contentions see *Adair v. United States*, 208 U. S. 178; *Butte City Water Co. v. Baker*, 196 U. S. 126; *Battfield v. Stranahan*, 192 U. S. 470; *Employers' Liability Cases*, 207 U. S. 497; *Second Employers' Liability Cases*, 223 U. S. 1; *Field v. Clark*, 143 U. S. 649; *Gibbons v. Ogden*, 9 Wheat. 1; *Hippolite Egg Co. v. United States*, 220 U. S. 45; *Hoke v. United States*, 227 U. S. 308; *Ill. Cent. R. R. Co. v. Int. Comm. Com.*, 206 U. S. 441; *Int. Comm. Com. v. Goodrich Transit Co.*, 225 U. S. 194; *Light v. United States*, 220 U. S. 523; *Lottery Case*, 188 U. S. 353; *Prentiss v. Atlantic Coast Line*, 211 U. S. 210; *Smyth v. Ames*, 169 U. S. 466; *The Daniel Ball Case*, 10 Wall. 557; *Union Bridge Co. v. United States*, 204 U. S. 384; *Union Pacific R. R. Co. v. United States*, 99 U. S. 402; *United States v. Grimaud*, 220 U. S. 566; *Wayman v. Southard*, 10 Wheat. 142; *Montgomery on Auditing, Theory and Practice* (1912).

MR. JUSTICE PITNEY, after making the foregoing statement, delivered the opinion of the court.

The contention of appellant in the Commerce Court and in this court is, that the regulations of the Interstate Commerce Commission relative to the method of keeping the accounts of common carriers, so far as they are here questioned, are unreasonable, beyond the power or authority of either Congress or the Commission, and violative of the Fifth Article of Amendments to the Constitution of the United States, as being a deprivation of property without due process of law. It is claimed that the effect of enforcing the regulations under the circumstances of the case is to reduce the amount of net earnings applicable to dividends, and thereby cause an irreparable loss to the

preferred stockholders, whose dividends are non-cumulative and payable only out of the income of the current year; that the property accounts become inaccurate, because while appellant has actually expended something more than \$600,000 in the improvement of its property, and its bonded indebtedness has been in fact increased by the like amount, the accounts will declare that for this expenditure the company has obtained a net accretion to its property of only a little over \$200,000 (\$629,399.74 less \$386,484, or \$234,747.74); that the Operating Expense Accounts will be improperly swollen by the inclusion therein of the sum of \$386,484, to the deception of the stockholders and the investing public, and the impairment of the financial credit of the company; and that under the requirements of the Commission this sum of \$386,484 cannot be charged to and finally taken out of the proceeds of the bonds, but must be charged to operating expenses, and thus taken from operating revenue, because of which (as is claimed) this amount, which has already been paid out of the proceeds of bonds, must ultimately be restored in cash to the bond account, and returned to the trustee or otherwise accounted for to the bondholders. As to the Shreveport shop and terminal plant that are to be abandoned, it is contended that it is unreasonable to require the cost of abandonment to be charged to operating expenses, and that this is a proper charge against the accumulated surplus, as represented in the profit and loss account.

The authority of the Commission rests upon § 20 of the "Act to Regulate Commerce" (February 4, 1887, 24 Stat. 379, c. 104, as amended by the Hepburn Act of June 29, 1906, 34 Stat. 584, cc. 3591).<sup>1</sup> The constitu-

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<sup>1</sup>"Sec. 20. That the Commission is hereby authorized to require annual reports from all common carriers subject to the provisions of this Act, and from the owners of all railroads engaged in interstate commerce as defined in this Act, to prescribe the manner in which

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tional validity of this legislation was sustained in *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194, 211, 214.

The authority conferred by Congress upon the Commerce Court (act of June 18, 1910; 36 Stat. 539, c. 309;

such reports shall be made, and to require from such carriers specific answers to all questions upon which the Commission may need information. Such annual reports shall show in detail the amount of capital stock issued, the amounts paid therefor, and the manner of payment for the same; the dividends paid, the surplus fund, if any, and the number of stockholders; the funded and floating debts and the interest paid thereon; the cost and value of the carrier's property, franchises, and equipments; . . . the amounts expended for improvements each year, how expended, and the character of such improvements; the earnings and receipts from each branch of business and from all sources; the operating and other expenses; the balances of profit and loss; and a complete exhibit of the financial operations of the carrier each year, including an annual balance sheet. Such reports shall also contain such information in relation to rates or regulations concerning fares or freights, or agreements, arrangements, or contracts affecting the same as the Commission may require; and the Commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this Act, prescribe a period of time within which all common carriers subject to the provisions of this Act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept.

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The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic as well as the receipts and expenditures of moneys. The Commission shall at all times have access to all accounts, records, and memoranda kept by carriers subject to this Act, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda kept by such carriers. This provision shall apply to receivers of carriers and operating trustees."

Judicial Code, § 207) with respect to enjoining or setting aside the orders of the Commission, like the authority previously exercised by the Federal Circuit Courts, was confined to determining whether there had been violations of the Constitution, or of the power conferred by statute, or an exercise of power so arbitrary as virtually to transcend the authority conferred. *Interstate Com. Com. v. Illinois Central R. Co.*, 215 U. S. 452, 470; *Interstate Com. Com. v. Union Pacific R. Co.*, 222 U. S. 541, 547; *Procter & Gamble v. United States*, 225 U. S. 282, 297; *Interstate Com. Com. v. Balt. & Ohio R. Co.*, 225 U. S. 326, 340.

As to the intent and meaning of § 20, it is first insisted that the power conferred upon the Commission to prescribe the forms of accounts, records, and memoranda to be kept by the carriers, recognizes a distinction between the form and the substance; and that while the Commission, in order to obtain full and accurate information concerning the affairs of each corporation, must have power to require any reports, schedules, and accounts necessary to show the true financial condition of each carrier; yet that the grant must by fair interpretation, and in order not to amount to an unconstitutional delegation of legislative power, stop short of the point where the regulation in its essence goes not to the form but to the substance and involves interference with the internal affairs of the corporation. We do not, however, think that any such distinction between the form and the substance is admissible with respect to the declared object of standardizing railroad accounts and obtaining therefrom full and accurate information concerning the affairs of the respective corporations. The very object of a system of accounts is to display the pertinent financial operations of the company, and throw light upon its present condition. If they are to truly do this, the form must correspond with the substance. In order that accounts may be standard-

ized, it is necessary that the accounts of the several carriers shall be arranged under like headings or titles; and it is obviously essential that charges and credits shall be allocated under the proper headings—the same with one carrier as with another. Unless “Additions and Betterments,” on the one hand, and “Operating Expenses,” on the other, are to indicate the same class of entries upon the books of one carrier that they indicate upon the books of other carriers, there is no possibility of standardization. So far as such uniformity requirements control or tend to control the conduct of the carrier in its capacity as a public servant engaged in interstate commerce, they are within the authority constitutionally conferred by Congress upon the Commission. There is no direct interference with the internal affairs of the corporation; and if any such interference indirectly results, it is only such as is incidental to the lawful control of the carrier by the Federal authority and to this the rights of stockholders and bondholders alike are necessarily subject.

It is said, however, that the meaning of the term “operating expenses” was well defined at the time of the passage of the act of 1887, and that during the period intervening between the beginning of the work of the Commission thereunder and the passage of the Hepburn Act in 1906, the term had never been construed to include any charge for property abandoned in the course of improvements; and that this settled construction, upon familiar principles, must be deemed to have entered into the purpose of Congress when it reënacted the language of § 20 in the latter year, and added to it authority to the Commission to prescribe in its discretion the forms of accounts and a prohibition against keeping any others than those prescribed or approved by the Commission. But it will be observed that § 20, as originally enacted, authorized the Commission “in its discretion for the purpose of enabling it the better to carry out the purposes of this act,

[to] prescribe a period of time within which all common carriers subject to the provisions of this act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept." Congress, when it enacted the Hepburn Act in 1906, must have known that the Commission had not as yet found occasion to enforce this provision; and at the same time may be deemed to have contemplated that the authority then for the first time conferred upon the Commission to determine and prescribe the maximum rates to be charged by the carriers for the services to be performed by them, furnished a new and more cogent reason for establishing a uniform system of accounts.

The contention that the term "operating expenses" had a well-understood and defined meaning either recognized at the time of the passage of the act of 1887 or established by the constant practice of the Commission from that time until the Hepburn Act, so that the use of the term in the latter act amounted to an express limitation upon the grant of power to prescribe the forms of the accounts, is not well founded. Congress, in authorizing the Commission to prescribe a uniform system of accounts, recognized that accounting systems were not then uniform; and in reiterating this authorization in 1906, and adding a prohibition against the keeping of other accounts than those prescribed, manifested a purpose to standardize and render uniform the accounts of the different carriers with respect to matters that entered into property and the improvements thereof, on the one hand, and the current operations of the company, on the other. By the very terms of § 20, Congress at least outlined the classification of the carriers' accounts, for it required the annual reports to show "the amount of capital stock issued, the amounts paid therefor, and the manner of payment for the same . . . the surplus fund, if any, . . . the funded and floating

debts, . . . the cost and value of the carrier's property, franchises and equipments; . . . the amounts expended for improvements each year, how expended, and the character of such improvements; the earnings and receipts from each branch of business and from all sources; the operating and other expenses; the balances of profit and loss; and a complete exhibit of the financial operations of the carrier each year, including an annual balance sheet." By the same section the Commission was authorized to require these annual reports from all carriers subject to the Act, and to prescribe the manner in which the reports should be made, and for this and other purposes to require carriers to have "as near as may be, a uniform system of accounts, and [to prescribe] the manner in which such accounts shall be kept."

Plainly, the law-making body recognized the essential distinctions between property accounts and operating accounts, between capital and earnings; it recognized that the practice of different carriers varied in respect to these matters; and that no system of supervision and regulation would be complete without requiring the accounts of all the carriers to speak a common language.

There is here no unconstitutional delegation of legislative powers. The reasoning adopted in *Interstate Com. Com. v. Goodrich Transit Co.*, 224 U. S. 194, 210, etc., is controlling. And since, as just shown, uniformity in accounting is dependent upon the adoption and enforcement of precise classification, the authority to define the terms of the classification necessarily follows. It amounts, after all, to no more than laying down the general rules of action under which the Commission shall proceed, and leaving it to the Commission to apply those rules to particular situations and circumstances by the establishment and enforcement of administrative regulations.

It is contended that the regulations of the Commission, in respect to the matters now under consideration, are



so unreasonable and arbitrary as to constitute an abuse rather than an exercise of the powers conferred by § 20, and consequently that they ought to be set aside by judicial action. This is not on the ground that the Commission did not proceed with due deliberation and after proper inquiry. Respecting this, the record abundantly shows that in the year 1906, and shortly after the passage of the Hepburn Act, the Commission undertook, and for nearly three years prosecuted a most thorough investigation into the current practice of the principal railroad lines, procuring reports and recommendations from experts, and submitting tentative plans for the classification of accounts to the executives of the railroad lines and to a committee of accountants created by the Association of American Railway Accounting Officers, which association was made up of members representing practically every important railroad in the country.

The present attack upon the classification as adopted is, and must be, rested at bottom upon the contention that the regulations embodied in it are so entirely at odds with fundamental principles of correct accounting as intrinsically to manifest an abuse of power.

There is evidence in the record that substantially the same method of distributing charges for so-called "Additions and Betterments" between the Property Accounts and the Operating Accounts is and has long been pursued by important railroad carriers, and has received the sanction of at least one recent text-book writer,—Whitten, *Valuations of Public Service Corporations*, §§ 450, 451, 458, etc. Nevertheless, it is insisted with emphasis that property abandoned as an incident to permanent improvements is not an operating expense, and, in effect, that no matter what practice may be pursued by railroad accounting officers, it cannot properly be treated as such.

We are thus brought back to the fundamental distinction between (a) the property or capital accounts, designed

to represent the investment of the stockholders, and to show the cost of the property as originally acquired, with subsequent additions and improvements; these assets being balanced by the liabilities, including the amount of the capital stock and of bonded and other indebtedness, with net profits or surplus, whether carried under the head of "profit and loss" or otherwise; and (b) the operating accounts, designed to show, on the one side, gross receipts or gross earnings for the year, and on the other side, the expenditures involved in producing those gross earnings and in maintaining the property, the balance being the net earnings.

Since the regulation of the railroad carrier by the public authority, and especially the fixing of the rates to be charged, depend primarily upon two fundamental considerations, (a) the value of the property that is employed in the public service, and (b) the current cost of carrying on that service, it is clear that the maintenance of a proper line of distinction between property accounts and operating accounts is essential to the execution by the Interstate Commerce Commission of the supervisory and regulatory powers conferred upon it by Congress.

Appellant contends, *inter alia*, that since the original locations were necessary in the development of its railroad line, and were abandoned only as an incident to the improvement and development of the property, the cost thereof, being as it is termed a part of the "cost of progress," should remain in the property account, as representing a part of the stockholders' present investment.

Support for this contention is sought in previous decisions of this court. In *Union Pacific R. Co. v. United States*, 99 U. S. 402, a decision that turned upon the meaning and effect of an act of July 1, 1862 for aiding the construction of the railroad (12 Stat. 489, c. 120), it was said, at p. 420: "As a general proposition, net earnings are the excess of the gross earnings over the expenditures de-

frayed in producing them, aside from, and exclusive of, the expenditure of capital laid out in constructing and equipping the works themselves. It may often be difficult to draw a precise line between expenditures for construction, and the ordinary expenses incident to operating and maintaining the road and works of a railroad company. Theoretically, the expenses chargeable to earnings include the general expenses of keeping up the organization of the company, and all expenses incurred in operating the works and keeping them in good condition and repair; whilst expenses chargeable to capital include those which are incurred in the original construction of the works, and in the subsequent enlargement and improvement thereof." In *Illinois Central R. R. v. Interstate Commerce Commission*, 206 U. S. 441, the Commission had held (206 U. S. 449; 10 I. C. C. 544) that while repairs were properly chargeable to current operating expenses, yet expenditures for improvements and equipment "should not be taxed as part of the current or operating expenses of a single year, but should be, so far as practicable, and so far as rates exacted from the public are concerned, projected proportionately over the future." And in this court it was said (p. 462): "It would seem as if expenditures for additions to construction and equipment, as expenditures for original construction and equipment, should be reimbursed by all of the traffic they accommodate during the period of their duration, and that improvements that will last many years should not be charged wholly against the revenue of a single year." And, after pointing out that the case of the Union Pacific Railway Company in 99 U. S. had to do not with rates of transportation or the like, but with the construction of the words "net earnings" in an act of Congress, the court, in pointing out the difference between the position of the Government in that case and the position of a shipper of commodities in the case *sub judice*, said, with respect to the latter (p. 463):

"His right is immediate. He may demand a service. He must pay a toll, but a toll measured by the reasonable value of the service. The elements of that value may be many and complex, not always determinable, as we have seen, with mathematical accuracy, but, we think, it is clear, that instrumentalities which are to be used for years should not be paid for by the revenues of a day or year; and this is the principle of returns upon capital which exists in durable shape."

The expressions quoted were properly employed with respect to the questions then presented for decision. As expressions of the general principle, we see no occasion now to qualify them. In both cases it was recognized that in so complicated a matter as the construction, maintenance, and operation of a railroad line, it is difficult to define and perhaps more difficult to consistently apply a precise distinction between capital and expense accounts; and while the propriety of distributing improvement costs over a series of years was recognized, the impossibility of scientific accuracy in that regard was acknowledged. The question now is, whether the regulations of the Commission under attack do violence to these general principles—rather, it is whether those regulations are so clearly contrary to these and other applicable principles that they should be set aside as being in excess of the powers conferred by Congress upon the Commission.

We are unable to see that there is substantial inconsistency with principle, much less gross violation thereof. The contention of the appellant that property, originally acquired because necessary in the construction of the road, and afterwards abandoned only because rendered unnecessary by the improvement and development of the property, should remain in the property account as a part of the stockholders' investment, will be found, upon analysis, to rest upon the unwarrantable assumption that all capital expenditures result in permanent accretions to the

property of the company. This in effect ignores depreciation—an inevitable fact which no system of accounts can properly ignore. A more complete depreciation than that which is represented by a part of the original plant that through destruction or obsolescence has actually perished as useful property, it would be difficult to imagine. The fact that the original investment was necessary in order that the second investment might be made is not a conclusive test. Reference is made to the cost of the scaffolding used in the erection of a house, and discarded when the house is completed; and to the cost of the paper that goes to the waste-basket, rather than to the printer, in the preparation of a literary composition; but these are fanciful analogies, and do not assist us here, where the real question is not how shall original cost be ascertained, but, how shall subsequent depreciation in value be reckoned and accounted for?

In *Knoxville v. Water Co.*, 212 U. S. 1, this court had to do with a similar element of depreciation, and, after pointing out that such a plant as was there in question begins to depreciate in value from the moment of its use, and that before coming to the question of profit at all, the company was entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they should come to the end of their life, the court proceeded to say (p. 14): "If, however, a company fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired, whether this is the result of unwarranted dividends upon overissues of securities, or of omission to exact proper prices for the output, the fault is its own. When, therefore, a public regulation of its prices comes under question the true value of the property then employed for the purpose of earning a return cannot be enhanced by a consideration of the errors in management which have been committed in the past."

And since one of the manifest objects of Congress in authorizing the supervision and standardization of carriers' accounts, as is done in § 20 of the Interstate Commerce Act, was to enable the Commissioners to intelligently perform their duties respecting the regulation of carriers' rates for the services performed, and since it is settled that the property investment which is to be taken into consideration as one of the elements in fixing such rates is the property then in use (*Smyth v. Ames*, 169 U. S. 466, 546; *San Diego Land & Town Co. v. National City*, 174 U. S. 739, 757; *San Diego Land & Town Co. v. Jasper*, 189 U. S. 439, 442; *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 41; *Minnesota Rate Cases*, 230 U. S. 352, 434, 454, 458), it is obvious that so far as the regulations of the Commission now under consideration discard the "cost of progress" theory, they need no further vindication.

It is insisted that if the appellant, having expended in round figures \$600,000, secured by the sale of bonds for improvements, can be compelled to charge \$400,000 of that amount to the operating expense of one year or to distribute it among the operating expenses of a series of years, and if it be forbidden to keep any other record representing the transaction, it will have in its possession no kind of record from which it can report accurately either the cost of its property or the cost of improvements or its operating expenses. This, we think, is a misapprehension of the effect of the regulations. They do not require appellant to falsify its books or to change in any way the evidential character of the original entries. The source of the money, and the disposition made of it as expended, may and should be correctly shown. The regulations do require that the contemporaneous abandonment of other property be likewise shown, and the replacement cost, less salvage, charged to the appropriate accounts under operating expenses. This, if observed, of course results

in enforcing a prescribed distinction between capital expense and operating expense. It does not require that the record of the expenditure be obliterated; but it does of course affect the results as they work out upon the balance-sheet. If this be fairly done, there is no transmutation of new property into operating expenses, but only an insistence upon the requirement that new property added shall not alone be the measure of the accretion to the property account, and that the depletion attributable to contemporaneous abandonment of other property shall likewise be reflected upon the books.

Stress is laid upon the fact that if the grade reductions in question had been made upon the line of the original right of way, even though made at double the expense, the cost would have gone into "additions and betterments," and would have stood as a permanent increment of assets in the property account; while with respect to similar improvements made off the line of the original right of way, appellant is not permitted to carry into the property account the full cost of the improvement, but must first deduct therefrom the estimated replacement cost (less salvage) of the portions of track no longer used, charging this to the account of operating expenses.

So far as the comparative expense of the different modes of improvement is concerned, little need be said. The accounting regulations do not seek to control railroad companies in the exercise of their discretion respecting what shall be done and how it shall be done, but only to systematize their accounts with respect to whatever is done. It is to be presumed that boards of directors will select that method of accomplishing a needed grade revision that shall be preferable from the engineering standpoint and suited to the financial condition and prospects of the company; not that they will adopt an inferior or more costly method of improvement because of the accounting requirements.

The distinction drawn between grade improvements "off the line" and those made "on the line" rests upon the view that the discarding of sections of the original line of road is a loss or depreciation that in correct accounting should be taken out of the property account. If this is to be done, its value must be charged, directly or indirectly, as an expense incident to the operation of the road. Whether it should be charged against the accumulated profits of previous years, as reflected in the profit and loss account, or against the profits of present and future years, may depend upon circumstances. The theory upon which the Commission has acted in formulating its regulations is fairly stated in its brief herein as follows: The abandonment of property incident to grade revision is "depreciation," and such depreciation is of two kinds,—(1) that which is not replaced in kind, and (2) that which is replaced by improved materials, track, or equipment. If a trunk line of road has a branch extending into a territory not served by its main line, and, finding the branch unprofitable, abandons it, taking up the track, without constructing any substitute to serve the same territory, the abandoned branch ceases to be an earning instrumentality; the stockholders can thereafter derive no profit from it; it has served its purpose, and only past operations have benefited from it. So far as the profits of past operations have not been distributed to the stockholders, they are represented in the profit and loss account, and therefore such an abandonment or depreciation is properly chargeable to that account unless a special depreciation account has been established in anticipation of such abandonments; and for such an account, provision is made in the regulations. The other kind of depreciation is the result of changes attributable to the inadequacy of the existing property to meet the demands of the future. The road or the structures have to be replaced with stronger or more efficient instrumentalities. Abandon-



ments occasioned by changes of this character are therefore chargeable to future earnings, for the reason that the improved condition of the road is not only designed to meet the demands of the future, but presumably will result in economies of operation, and so the resulting benefits will be reaped by those who hold the stock of the company in the present and in the future. The railroad company may, if it sees fit, anticipate general depreciations, and make provision for them by establishing a reserve for the purpose; but if no such provision has been made the abandonments should be taken care of by charging them to present or future operating expense. In case, however, the amount is so large that its inclusion in a carrier's operating expenses for a single year would unduly burden the operating expense account for that year, the carrier may, if so authorized by the Commission, distribute the cost throughout a series of years.

A statement of the theory is sufficient to show that the regulation is not arbitrary in the sense of being without reasonable basis. And there is evidence to show that the Commission was warranted in adopting it, as sustained by expert opinion and approved by experience.

One of the reasons for the distinction made in accounting between improvements made on, and those made off, the old right of way is that in the former case the improvements show themselves in the physical structures, and can be inventoried and appraised by witnesses; the deepening of cuts and increasing of fills, while involving some abandonments (and these under the regulations are to be taken out of the operating account), yet in the main are visible upon the ground, and capable of mensuration and appraisement. To the suggestion that cuts filled up and embankments reduced would not be thus manifest, it is sufficient to say that if such cases occur they must be most extraordinary. When a railroad is originally constructed, cuts and fills are made to overcome natural

inequalities of surface; if any undue grades are permitted to remain, it is usually because for reasons of economy cuts have been made less deep and fills less high than otherwise they would have been made. Therefore grade revisions upon the line of the original right of way are normally required for the purpose of removing summits in cuts and raising sags in fills; not *vice versa*.

It is said that the effect of the regulations, if complied with, is to deprive the preferred stockholders of a considerable part of the non-cumulative dividends from the net earnings of the company, to which they would otherwise be entitled. The preferred stockholders, as such, are not before the court, and this is not a proper occasion for determining their rights. Supposing, however, that the enforcement of the accounting system does require them to forego their current dividends, we do not concede that this amounts to an unlawful taking of their property. Assuming (as of course we must) that the management of the company has acted prudently in making these extensive improvements within a short time, instead of distributing them throughout a series of years, and without providing in advance any fund applicable to them, still it must be presumed that the improvements are necessary to the general welfare of the company, and will result in its increased prosperity, and therefore make better the assurance of dividends for the preferred stockholders in the future.

But, aside from that, the Interstate Commerce Act deals with the carrier in its capacity as a servant of the public, and as a distinct entity, amenable to the legitimate regulation of Congress and the Commission. If in this aspect the carrier is not unwarrantably injured or deprived of its property by the exercise of the regulatory powers, the operation of such regulations cannot be restrained on the ground of agreements made by the stockholders amongst themselves for apportioning profits to one or the

other class of stockholders. To admit this might materially hamper the Federal control over interstate carriers, and evidently would tend to render impracticable the standardization of methods of accounting.

Much stress is laid upon the situation that results from the circumstance that (as is claimed) these regulations were promulgated after appellant had mortgaged its property and issued bonds for financing the improvements in question. It is not contended that the regulations impair the rights of either party under the mortgage. The contention is that the company had the right to finance the full cost of the improvements out of the proceeds of a bond issue, and that the regulations amount in effect to a veto upon the action of the directors in this respect. Supposing this to be true, we are unable to perceive that the appellant is thereby relieved from compliance with the regulations. Whatever was done about authorizing the improvements and financing the cost from the bond issue was done subject to being displaced by the exercise of the powers conferred upon the Interstate Commerce Commission by the act of 1906. The regulations do not affect the administration of the borrowed money. It was borrowed *inter alia* specifically for use in "reducing grades to one-half of one per cent. on three full operating divisions, aggregating 41 per cent. of the total length of the line." And by the mortgage appellant covenanted to use the bonds and the proceeds thereof in calling in and redeeming an outstanding loan, "and for the general improvement of its property." In short, so far as appears, there is nothing in the regulations to prevent the appellant from devoting the money strictly to the purposes for which it was borrowed, although they do prevent the keeping of the accounts in such manner as to make it appear that the book value of the company's assets is enhanced to the full extent of the moneys disbursed in the improvements.

When it is said that the amount of \$386,484, which under the requirements of the Commission must be charged to operating expenses, must for that reason be ultimately restored in cash to the bond account and returned to the trustee or otherwise accounted for to the bondholders, this does not mean that any obligation of that kind is imposed upon appellant by the classification. We are not referred to anything in the classification, in the provisions of the mortgage, or in the law, that imposes any such duty. What is meant (as we presume), is that if the operating expenses are increased and the operating revenue decreased by the amount mentioned, in accordance with the regulations, and the payment of dividends should nevertheless continue, the books would make it appear that the dividends were paid not from earnings but from the proceeds of the bonds. In other words, the regulations of the Commission prevent the proceeds of the bond issue from being used, in whole or in part, to maintain dividend payments *without that fact appearing upon the accounts*; and since it is improbable that appellant would be willing to have the accounts bear such an interpretation, it is probable that the proceeds of the bonds will not be employed for dividend purposes, and unless required for further improvements, may as well be returned to the trustee for the bondholders. Since one of the very purposes of establishing the accounting system is to deter the payment of dividends out of capital, the criticism, upon analysis, bears its own refutation.

The same may be said of the argument that enforcement of the regulations will impair the credit of appellant by diminishing apparent earnings, preventing continuance of dividends upon preferred stock and keeping down the aggregate value of "assets" upon the property accounts. Presumably the regulations have a tendency to place the accounting system upon a sound basis in these respects; and to accomplish this was one of the legitimate

objects at which Congress aimed in the enactment of § 20 of the Interstate Commerce Act.

It is further insisted that even the theory upon which the accounting regulations rest does not, when analyzed, justify a charge of abandoned property to operating expenses, but at most a charge to profit and loss. The suggestion apparently has force; but, upon consideration, we are unable to see that it furnishes ground for judicial interference with the course pursued by the Commission. Except for the contention (already disposed of) that the value of the abandoned parcels should be permanently carried in the property account as part of the cost of progress, it is and must be conceded that sooner or later it must be charged against the operating revenue, either past or future, if the integrity of the property accounts is to be maintained; and it becomes a question of policy whether it should be charged *in solido* to profit and loss (an account presumptively representative of past accumulations) or to the operating accounts of the present and future. If abandoned property is not charged off in one way or the other it remains as a permanent inflation of the property accounts, and tends to produce, directly or indirectly, a declaration of dividends out of capital. If it be charged off to the surplus account, it tends to prevent the declaration of dividends based upon a supposed accumulation of past earnings. If charged to operating expenses of the current and future years, it has a tendency to prevent the declaration of dividends from current earnings until the amount of the depreciation shall have been made up out of the earnings.

But, did we agree with appellant that the abandonments ought to be charged to surplus or to profit and loss, rather than to operating expenses, we still should not deem this a sufficient ground to declare that the Commission had abused its power. So long as it acts fairly and reasonably within the grant of power constitutionally con-

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ferred by Congress, its orders are not open to judicial review.

What has been said respecting the enforced disposition of the charges for property abandoned in grade revision, applies as well to the abandonment of the present shop and terminal plant at Shreveport.

*Decree affirmed.*

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